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**TRANSCRIPT OF RECORD**

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**Supreme Court of the United States**

**OCTOBER TERM, 1947**

**No. 95**

*< see 76-105 >*

**ALEXANDER WOOL COMBING COMPANY,  
PETITIONER,**

**vs.**

**THE UNITED STATES OF AMERICA**

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**ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT  
OF APPEALS FOR THE FIRST CIRCUIT**

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**PETITION FOR CERTIORARI FILED MAY 19, 1947.**

**CERTIORARI GRANTED JUNE 16, 1947.**

**UNITED STATES CIRCUIT COURT OF APPEALS  
FOR THE FIRST CIRCUIT.**

**OCTOBER TERM, 1946.**

**No. 4205.**

**ALEXANDER WOOL COMBING COMPANY,**  
**DEFENDANT, APPELLANT,**

**v.**

**UNITED STATES OF AMERICA,**  
**PLAINTIFF, APPELLEE.**

**APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES  
FOR THE DISTRICT OF MASSACHUSETTS,  
FROM JUDGMENT (WYZANSKI, J.), JUNE 21, 1946.**

**TRANSCRIPT OF RECORD.**

**EDWARD C. PARK,**  
**WITHINGTON, CROSS, PARK & McCANN,**  
*for Appellant.*

**EDMUND J. BRANDON,**  
**UNITED STATES ATTORNEY,**  
**GEORGE F. GARRITY,**  
**ASSISTANT U. S. ATTORNEY,**  
*for Appellee.*





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**UNITED STATES CIRCUIT COURT OF APPEALS  
FOR THE FIRST CIRCUIT.**

**OCTOBER TERM, 1946.**

**No. 4205.**

**ALEXANDER WOOL COMBING COMPANY,  
DEFENDANT, APPELLANT,**

**v.**

**UNITED STATES OF AMERICA,  
PLAINTIFF, APPELLEE.**

**TRANSCRIPT OF RECORD OF THE DISTRICT COURT.**

**CIVIL ACTION 4121.**

**UNITED STATES OF AMERICA, Plaintiff,**

**v.**

**ALEXANDER WOOL COMBING COMPANY, Defendant.**

**APPEAL OF PLAINTIFF ALEXANDER WOOL COMBING  
COMPANY FROM FINAL JUDGMENT ENTERED  
JUNE 21, 1946.**

The Complaint in this cause was filed on August 9, 1945, and was duly entered at the June Term, 1945, of this court.

**COMPLAINT.**

**[Filed August 9, 1945.]**

The plaintiff by Edmund J. Brandon, United States attorney, and George F. Garrity, assistant United States attorney, brings this complaint and avers as follows:

1. The defendant, Alexander Wool Combing Company, is a



## Transcript of Record of District Court.

corporation duly organized and existing under the laws of the Commonwealth of Massachusetts, and doing business at Lowell within the District of Massachusetts.

2. This action is brought pursuant to Section 403 (c) of the Renegotiation Act.

3. After notice to defendant, proceedings for the renegotiation of defendant's contracts and subcontracts were had and conducted by representatives of the secretary of war. Thereafter and on the sixth day of September, 1944 the under secretary of war, acting under and by virtue of the Renegotiation Act and pursuant to authority delegated to him, duly determined that of the profits realized by defendant for the fiscal year of defendant ended June 30, 1942 on defendant's contracts and subcontracts subject to renegotiation twenty-two thousand five hundred dollars (\$22,500) thereof were excessive profits and that of the profits realized by defendant during its fiscal year ended June 30, 1943, on defendant's contracts and subcontracts subject to renegotiation forty-five thousand dollars (\$45,000) thereof were excessive profits. Duplicate originals of each such order and determination were sent to the defendant by mail on September 6, 1944. Full, true and correct copies of the orders and determinations of the under secretary of war are attached hereto as Exhibits A and B.

4. The tax credit to which defendant is entitled under Section 3806 of the Internal Revenue Code with respect to the determination for the fiscal year ended June 30, 1942 is fifteen thousand twenty dollars eighty cents (\$15,020.80). The tax credit to which defendant is entitled under Section 3806 of the Internal Revenue Code with respect to the determination for the fiscal year ended June 30, 1943 is thirty-six thousand five hundred ninety-six dollars forty-two cents (\$36,596.42).

5. The defendant was directed by the aforesaid orders and determinations of the secretary of war to repay to the treasurer of the United States said excessive profits less the appropriate tax credits.

6. The defendant has not petitioned The Tax Court of the United States for a redetermination of the orders made by the

under secretary of war as provided in Section 403(e) of the Renegotiation Act and the period for filing such a petition has expired.

7. The defendant has not paid the United States and the United States has not withheld or by any other method eliminated said excessive profits in the total amount of sixty-seven thousand five hundred dollars (\$67,500) less the tax credits aforesaid nor any part thereof. Said amount is now due, owing and unpaid.

Wherefore, plaintiff prays judgment against defendant in the sum of fifteen thousand eight hundred eighty-two dollars seventy-eight cents (\$15,882.78) with interest at 6 per cent per annum from the sixth day of September, 1944, and costs.

EDMUND J. BRANDON, *United States Attorney,*

*by* GEORGE F. GARRITY,

*Assistant United States Attorney,*

1115 Federal Building, Boston, Massachusetts.

EXHIBIT A.

Copy

War Department

Office of the Under Secretary Washington

DETERMINATION OF EXCESSIVE PROFITS

Pursuant to Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, which term refers to said Act as last amended 14 July 1943 and as affected by Title VII of the Revenue Act of 1943 so far as applicable.

Whereas, Alexander Wool Combing Company (hereinafter referred to as the Contractor), holds contracts and subcontracts subject to renegotiation pursuant to the provisions of Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended (hereinafter referred to as the Act); and

Whereas, renegotiation has taken place between the Under

4  
Transcript of Record of District Court.

Secretary of War and the Contractor, pursuant to the provisions of the Act, for the purpose of eliminating excessive profits realized by the Contractor during its fiscal year ended 30 June 1942, under said contracts and subcontracts; and

Whereas, as a basis for said renegotiation the Under Secretary of War considered certain financial, operating and other data, submitted by the Contractor or obtained by the Under Secretary of War from governmental or other reliable sources, relating to the profits realized by the Contractor during said fiscal year under said contracts and subcontracts; and

Whereas, the Contractor has been granted full opportunity to submit such additional information and to present such contentions as the Contractor deemed material in determining the excessiveness of said profits and the renegotiability of such contracts and subcontracts, at hearings of which due notice was given, and due consideration has been given to the financial, operating and other data and information so furnished or obtained and each of the contentions so presented;

Now, Therefore, pursuant to the authority and discretion vested in the Secretary of War, the Secretary of the Navy, the Secretary of the Treasury, the Chairman of the Maritime Commission, the Administrator of the War Shipping Administration, and the respective Boards of Directors of the Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation and Rubber Reserve Company under the provisions of the Act, and duly delegated to the Under Secretary of War under subsection (f) thereof, it is hereby found and determined:

That \$22,500 of the profits realized by the Contractor during its fiscal year ended 30 June 1942, under its contracts and subcontracts subject to renegotiation pursuant to the provisions of the Act, are excessive.

That in connection with the payment or discharge by any means of the amount of excessive profits determined hereby to have been realized by the Contractor, the Contractor shall be credited with any amount to which it may be entitled under Section 3806 of the

Internal Revenue Code as computed by the Commissioner of Internal Revenue.

That the Contractor is directed to repay such excessive profits less such tax credit, if any, to the Treasurer of the United States.

That the excessive profits so found and determined shall be eliminated by any of the methods provided in the Act or any combination thereof; and the Commanding General, Army Service Forces, and the Commanding General, Army Air Forces, are hereby authorized and directed to take any and all action which may be necessary or desirable to effect such elimination.

6 September 1944

(s) ROBERT P. PATTERSON

Robert P. Patterson

Under Secretary of War

**EXHIBIT B.**

Copy

War Department

Office of the Under Secretary Washington

**DETERMINATION OF EXCESSIVE PROFITS**

\*Pursuant to Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, which term refers to said Act as last amended 14 July 1943 and as affected by Title VII of the Revenue Act of 1943 so far as applicable.

Whereas, Alexander Wool Combing Company (hereinafter referred to as the Contractor), holds contracts and subcontracts subject to renegotiation pursuant to the provisions of Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended (hereinafter referred to as the Act); and

Whereas, renegotiation has taken place between the Under Secretary of War and the Contractor, pursuant to the provisions of the Act, for the purpose of eliminating excessive profits realized by the Contractor during its fiscal year ended 30 June 1943, under said contracts and subcontracts; and



Whereas, as a basis for said renegotiation the Under Secretary of War considered certain financial, operating and other data, submitted by the Contractor or obtained by the Under Secretary of War from governmental or other reliable sources, relating to the profits realized by the Contractor during said fiscal year under said contracts and subcontracts; and

Whereas, the Contractor has been granted full opportunity to submit such additional information and to present such contentions as the Contractor deemed material in determining the excessiveness of said profits and the renegotiability of such contracts and subcontracts, at hearings of which due notice was given, and due consideration has been given to the financial, operating and other data and information so furnished or obtained and each of the contentions so presented;

Now, Therefore, pursuant to the authority and discretion vested in the Secretary of War, the Secretary of the Navy, the Secretary of the Treasury, the Chairman of the Maritime Commission, the Administrator of the War Shipping Administration, and the respective Boards of Directors of the Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation and Rubber Reserve Company under the provisions of the Act, and duly delegated to the Under Secretary of War under subsection (f) thereof, it is hereby found and determined:

That \$45,000 of the profits realized by the Contractor during its fiscal year ended 30 June 1943, under its contracts and subcontracts subject to renegotiation pursuant to the provisions of the Act, are excessive.

That in connection with the payment or discharge by any means of the amount of excessive profits determined hereby to have been realized by the Contractor, the Contractor shall be credited with any amount to which it may be entitled under Section 3806 of the Internal Revenue Code as computed by the Commissioner of Internal Revenue.

That the Contractor is directed to repay such excessive profits less such tax credit, if any, to the Treasurer of the United States.

That the excessive profits so found and determined shall be

eliminated by any of the methods provided in the Act or any combination thereof; and the Commanding General, Army Service Forces, and the Commanding General, Army Air Forces, are hereby authorized and directed to take any and all action which may be necessary or desirable to effect such elimination.

6 September 1944.

(s) ROBERT P. PATTERSON

Robert P. Patterson

Under Secretary of War

During the same term, on August 22, 1945, the following Answer was filed:

ANSWER.

[Filed August 22, 1945.]

FIRST DEFENSE.

The complaint fails to state a claim against defendant upon which relief can be granted.

SECOND DEFENSE.

Defendant admits the allegations of the complaint, except that it denies the allegations of paragraph 3 that the under secretary of war duly determined that defendant realized excessive profits on contracts and subcontracts subject to renegotiation for the fiscal years of defendant ended June 30, 1942 and June 30, 1943, and says that the orders and determinations made by the under secretary of war were null and void for the reasons stated in the other defenses asserted in this answer, and except that it denies that any amount is now due or owing to plaintiff from the defendant by reason of the facts alleged in the complaint.

THIRD DEFENSE.

Defendant is engaged in the business of scouring wool and combing it into tops and noils for commissions paid to it by the owners of said wool. It has never entered into any contract with any "Department", as that word is defined in the Renegotiation

Act. None of its contracts with others ever contained, or was required by the Renegotiation Act to contain, a provision under which defendant agreed to the elimination of excessive profits through renegotiation. As applied to the defendant the Renegotiation Act was unconstitutional because

a. It is repugnant to Article I, Sections 1 and 8, of the Constitution of the United States in that it unlawfully delegates legislative power to the secretaries of the departments and others;

b. It is repugnant to the Fifth Amendment to the Constitution of the United States in that it deprives defendant of property without due process of law;

c. It is repugnant to the Fifth Amendment to the Constitution of the United States in that it takes defendant's property for public use without just compensation;

d. It is repugnant to the Tenth Amendment to the Constitution of the United States in that it exercises a power not delegated to the United States.

#### FOURTH DEFENSE.

The determinations made by the under secretary of war that defendant realized excessive profits in its fiscal years ended June 30, 1942; and June 30, 1943, were null and void because made without due process of law, in that

a. They were made, in part, upon a consideration of certain financial, operating, and other data, not submitted by the defendant but obtained by the under secretary of war from other sources unknown to defendant and not offered at any hearing nor otherwise disclosed to defendant, although defendant requested a full disclosure thereof so that it might contradict or qualify the same by other evidence and offer argument as to the effect of such evidence;

b. They do not contain any findings of facts sufficient to justify the conclusion that defendant realized excessive profits in the years to which they relate;

c. They were made without any evidence that defendant had any contracts with a "Department", or any "subcontracts", as the

words quoted are used in the Renegotiation Act, but solely upon evidence that the work performed by defendant was upon wool, a substantial part of which was ultimately used by others in the manufacture of articles sold by them to a department;

d. They are based upon an erroneous principle, not warranted by the Renegotiation Act, that under war conditions a margin of profit as great as that obtained under competitive conditions in normal times is excessive.

By its Attorneys,

WITHINGTON, CROSS, PARK & McCANN,  
EDWARD C. PARK,

73 Tremont Street, Boston, Mass.

The cause was then continued from term to term to the December Term, 1945, when on January 9, 1946, the following Motions for Judgment on the Pleadings and for Summary Judgment were filed by the plaintiff:

**MOTIONS FOR JUDGMENT ON THE PLEADINGS AND  
FOR SUMMARY JUDGMENT.**

[Filed January 9, 1946.]

Now comes the plaintiff, the United States of America, and by its attorneys moves the court for judgment on the pleadings on the grounds that

- (a) Plaintiff is entitled to judgment as a matter of law on the undisputed facts appearing in the pleadings; and
- (b) The answer does not state a defense to the claim set forth in the complaint.

In the alternative plaintiff moves for summary judgment on the ground that there is no genuine issue as to any material fact and plaintiff is entitled to judgment as a matter of law.

This court has no jurisdiction of any question as to which The Tax Court of the United States is given exclusive jurisdiction by Section 403 (c) of the Renegotiation Act.



## Transcript of Record of District Court.

These motions are based upon the affidavits filed on behalf of plaintiff and on the pleadings, files and records in this case.

JOHN F. SONNETT,

*Assistant Attorney General.*

EDMUND J. BRANDON,

*United States Attorney.*

GEORGE F. GARRITY,

*Assistant United States Attorney.*

Of Counsel:

WALKER LOWRY,

A. MORRIS KOBRICK,

*Attorneys, Department of Justice.*

The cause was then continued to the March Term, 1946, when on April 2, 1946, the cause came on for trial without a jury, the Honorable Charles E. Wyzanski, Jr., United States District Judge sitting, and after full hearing was taken under advisement.

During the same term, on June 4, 1946, the court handed down its opinion in which it ordered judgment to be entered for the plaintiff.

During the same term, on June 21, 1946, the following Judgment was entered:

JUDGMENT.

June 21, 1946.

WYZANSKI, J. This action came on to be tried before this court, and the evidence produced by the parties having been heard it is hereby

Ordered, that the plaintiff, United States of America, recover of the defendant, Alexander Wool Combing Company, the sum of fifteen thousand eight hundred and eighty two dollars and seventy-eight cents (\$15,882.78), with interest at 6 per cent from September 6, 1944, to date of judgment amounting to one thousand seven hundred and seven dollars and thirty-two cents (\$1707.32), and

its costs taxed at \$  
therefor.

, and that said plaintiff have execution

By the Court,

EDITH G. ROLLINS,

*Deputy Clerk.*

Entered June 21, 1946.

CHARLES E. WYZANSKI, JR.,

*United States District Judge.*

From the foregoing judgment the defendant filed a notice of appeal to the United States Circuit Court of Appeals for the First Circuit on June 21, 1946, and on the same day filed the required bond for costs on appeal in the sum of \$250, Albert I. Alexander of North Andover in the Commonwealth of Massachusetts acting as surety.

OPINION.

June 4, 1946.

WYZANSKI, J. This is an action pursuant to § 403 (c) of the Renegotiation Act, 56 Stat. 226, 245 in which the United States seeks to recover from defendant "excessive profits" during defendant's two fiscal years ending June 30, 1942 and June 30, 1943.

The complaint states that on September 6, 1944 the under secretary of war, acting under the authority of the Renegotiation Act determined that of the profits realized by defendant during the fiscal year of defendant ending June 30, 1942 on its contracts and subcontracts subject to renegotiation \$22,500 were excessive profits, and that of the profits realized by defendant during the fiscal year of defendant ending June 30, 1943 on its contracts and subcontracts subject to renegotiation \$45,000 were excessive profits. Plaintiff attached copies of the two determinations. Plaintiff further alleged that defendant was entitled under § 3806 of the Internal Revenue Code to tax credits of \$15,020.80 and \$36,596.42; that defendant has not petitioned The Tax Court for re-determination of the excessive profits; that plaintiff has made

demand for the net balance; and that defendant has not made payment.

The statutory background for this action is somewhat complicated.

The original Renegotiation Act was enacted as Title IV of the Sixth Supplemental National Defense Appropriation Act, 1942, Act of April 28, 1942, c. 247, 56 Stat. 226, 244-247. Section 403 (c) 56 Stat. 245-246 provided that "the Secretary of each Department is authorized and directed, whenever in his opinion excessive profits have been realized . . . from any contract with such Department or from any subcontract thereunder, (1) to require the contractor or subcontractor to renegotiate the contract price, (2) to withhold from the contractor or subcontractor any amount of the contract price which is found as a result of such renegotiation to represent excessive profits, and (3) in case any amount of the contract price found as a result of such renegotiation to represent excessive profits shall have been paid to the contractor or subcontractor, to recover such amount from such contractor or subcontractor".

The original act was amended by Title VIII of the Revenue Act of 1942, Act of Oct. 21, 1942, c. 619, 56 Stat. 798, 982-985. Section 801 (a), 56 Stat. 982 of that Act provided that for the purposes of § 403 (a) of the Sixth Supplemental National Defense Appropriation Act,

"(4) The term 'excessive profits' means any amount of a contract or subcontract price which is found as a result of renegotiation to represent excessive profits.

"(5) The term 'subcontract' means any purchase order or agreement to perform all or any part of the work, or to make or furnish any article, required for the performance of another contract or subcontract. The term 'article' includes any material, part, assembly, machinery, equipment, or other personal property."

The same Section 801 (a) amended § 403 (c) (3) so as to provide that "in determining the amount of any excessive profits to

be eliminated hereunder the Secretary shall allow the contractor or subcontractor credit for Federal income and excess profits taxes as provided in Section 3806 of the Internal Revenue Code". [56 Stat. 983.] It further amended § 403 (c) (6) so as to provide that the Renegotiation Act "shall be applicable [with some exceptions] to all contracts and subcontracts hereafter made and to all contracts and subcontracts heretofore made". [56 Stat. 984.] Congress enacted other amendments subsequent to the ones already cited but they do not need to be commented upon now.

The material facts of this controversy can be shortly stated.

Defendant is a Massachusetts corporation engaged in the business of combing grease wool into tops and noils. During its fiscal years ending June 30, 1942 and June 30, 1943 it had no direct contracts with any department or agency of the United States. It combed wool for different private companies. It knew that some of the wool it combed for the companies was destined for use in Government contracts, but it was and is ignorant as to the destination of other wool.

In 1943 representatives of defendant conferred in Boston with representatives of the secretary of war in regard to renegotiation of defendant's contracts. In 1944 representatives of defendant appeared before a panel of the War Department Price Adjustment Board in Washington. At these meetings defendant submitted all the evidence which was sought. Defendant requested to be shown, but was denied the right to see, data on the sales, prices and profits of such other persons as the War Department considered in determining defendant's case. Defendant never received a statement from the War Department of the principles it applied in determining its case.

September 6, 1944 the under secretary of war issued the two determinations which are attached to the complaint and to which reference has already been made. Except for general recitals, these determinations do not give much detail as to what facts were taken into account or what reasons were considered controlling by the issuing authority.

It is defendant's position that these determinations cannot be



made the basis of any liability on its part because in its view (1) except by taxation or by eminent domain, Congress has no power even in time of war to require a person with whom the Government has no direct contract to yield to the Government excessive profits he has derived indirectly from contracts to which the Government and others are parties; (2) if Congress has such power, it has attempted, in violation of Article I of the United States Constitution, to delegate that power to executive officials without giving them any adequate standards to govern their discretion; and (3) even if Congress has such power and has properly delegated it to the executive, the executive in this case proceeded so arbitrarily as to deny the due process guaranteed by the Fifth Amendment, and such denial must be reviewable in a court established under Article III of the United States Constitution.

Defendant's first contention is that Congress cannot under the powers conferred by United States Constitution Article I enact legislation to recapture excessive profits made in time of war. The constitutional provisions which permit Congress in time of war to provide for the establishment of maximum prices (*Yakus v. United States*, 321 U.S. 414) and maximum rents (*Bowles v. Willingham*, 321 U.S. 503) also permit Congress to provide for renegotiation of contracts to recapture excessive profits. The aggregate of Constitutional powers usually called the war powers enables the national government (in order to protect itself from war profiteers and in order to keep within reasonable limits the cost of waging war) to recapture part of any unusually high profits made directly or indirectly from governmental contracts. Recapture of high profits is a not unprecedented legislative remedy, *Dayton-Goose Creek Railway v. United States*, 263 U.S. 456, and its economic impact upon the person whose profits are recaptured is from a constitutional viewpoint indistinguishable from the economic impact of a maximum price law upon a person whose sale prices are regulated. In each case a ceiling is applied so as to restrict the height to which profits and prices might otherwise rise. The fact that one ceiling is applied after and the other before the sale is not from the standpoint of Congressional war

power a significant constitutional difference, though it may be important as a business distinction.

Defendant's second contention is that the determinations are invalid because they are based upon a statute in which in violation of United States Constitution Article I delegated legislative power to an executive official without prescribing sufficient standards for his guidance. In particular, defendant asserts that the phrase "excessive profits" is a phrase without sufficient meaning to serve as a guide or standard. The answer to this contention is that so far as war powers are concerned, delegations of at least as broad scope and with as vague standards have been sustained. *Yakus v. United States*, 321 U.S. 414; *Bowles v. Willingham*, 321 U.S. 503; *O'Neal v. United States*, 140 F. (2d) 908 (C.C.A. 6). A similar answer to a similar contention was made in *R. E. Spaulding et al. v. Douglas Aircraft Company, Inc. et al.*, 154 F. (2d) 419 (C.C.A. 9).

Defendant's next contention is that the proceedings contemplated by the Renegotiation Acts and actually followed in its case deprive it of the due process of law guaranteed by the Fifth Amendment because they do not involve any detailed findings of fact and because they were based on facts and principles, if any, not disclosed to defendant. Neither detailed findings or hearings nor any statement of governing considerations are required because the defendant, if it was dissatisfied with the ultimate determination reached by the executive, had a statutory right to a suit *de novo* in The Tax Court of the United States.

That statutory right is set forth in Section 701 (b) of Title VII of the Revenue Act of 1943, Act of Feb. 25, 1944, c. 63, 58 Stat. 21, 87 which amended Section 403 of the Renegotiation Act by adding a new subsection 403 (e) (2). That subsection provides that "any . . . contractor or subcontractor . . . aggrieved by a determination of the Secretary made on or after the date of the enactment of the Revenue Act of 1943, with respect to any . . . fiscal year, as to the existence of excessive profits . . . may, within ninety days . . . after the date of such determination; file a

petition with The Tax Court of the United States for a redetermination thereof". Upon such filing The Tax Court conducts "a proceeding *de novo*" and has the same powers and duties as if the matter were "a proceeding to redetermine a deficiency" in income taxes. [58 Stat. 86-87.]

In short the statute provided that if defendant was not satisfied with the manner in which the secretary of war conducted proceedings, or with the chain of reasoning which he followed or with the result at which he arrived, defendant was free to go to another forum, The Tax Court. There, unembarrassed by the prior proceedings before the secretary of war, defendant could try out his case and procure the judgment of a fresh tribunal. Compare *Macauley v. Waterman Steamship Corporation*, Sup. Ct. of U.S. Oct. Term 1945, No. 435, March 25, 1946:

Thus, even if it be assumed that the proceedings before the secretary had an element of arbitrariness, and if it be assumed that the secretary of war applied to this defendant a capricious and highly individualized method of treatment, that arbitrariness would not have prejudiced defendant if, as provided by the Revenue Act of 1943, it had resorted to The Tax Court. Defendant's status now is exactly like that of the landowner in *Utley v. St. Petersburg*, 292 U.S. 106, 109, who was subjected to an assessment which he regarded as arbitrary but which, if he had acted promptly, he could have had examined *de novo* by an administrative tribunal. As Justice Cardozo said in recognizing liability on the assessment in that case:

"This court will not listen to an objection that the charge has been laid in an arbitrary manner when an administrative remedy for the correction of defects or inequalities has been given by the statute and ignored by the objector."

But defendant suggests that it is not bound to resort to the administrative agency known as The Tax Court because Congress has not provided any appeal from that agency to the courts and because questions of law and fact such as defendant seeks to raise

are questions as to which it is entitled to have the judgment at some stage either by a court established under Article III of the United States Constitution or by an administrative agency whose decision is reviewable in such a court. This point has already been raised and met in *Spaulding et al. v. Douglas Aircraft Company, Inc.*, *supra*. Therefore, it will be enough to answer the point summarily. It is by no means clear that a person who is required to surrender not his capital but merely a portion of his profits has a Constitutional right to have a so-called "Constitutional court" pass upon any question in his case. But if such a Constitutional right exists, it will be time enough for the holder of the right to assert it and for a court to pass upon it when The Tax Court has made its decision.

Defendant suggests that, in part, this complaint and the Renegotiation Act seek to reach profits earned just before the passage of the Act. It is defendant's claim that this retroactive application of the statute would be in violation of the Fifth Amendment to the United States Constitution. If that claim could prevail in the face of *Welch v. Henry*, 305 U.S. 134, and *United States v. Hudson*, 299 U.S. 498, the place to have raised it initially was The Tax Court. *Macauley v. Waterman Steamship Corp.*, *supra*.

That tribunal was also the place to raise the issue whether defendant was within the meaning of the Act a "subcontractor" and whether the profits it realized were within the coverage of the Act. *Macauley v. Waterman Steamship Corp.*, *supra*.

Defendant not having followed the administrative remedy provided by law and not having resorted to the proper tribunal to challenge the government's assessment, there shall be entered in accordance with the complaint and motion.

Judgment for plaintiff.

CHARLES E. WYZANSKI, JR.,

*United States District Judge.*



TRANSCRIPT OF PROCEEDINGS IN THE DISTRICT  
COURT.

April 2, 1946.

## Appearances:

EDMUND J. BRANDON, Esq., United States Attorney, by  
GEORGE F. GARRITY, Esq., Assistant United States  
Attorney, and

A. MORRIS KOBRICK, Esq., Attorney, Department of Justice,  
*for the Government.*

EDWARD C. PARK, Esq.,  
*for ALEXANDER WOOL COMBING COMPANY.*

## Evidence for Defendant.

BOSTON, MASS., April 2, 1946, 10 A.M.

The Court. This is going to be a mere argument, as I understand it, and I do not care to have it taken down unless counsel care to have it taken down.

Mr. Park. If your Honor please, I expect to put on evidence.

The Court. Oh, you do?

Mr. Park. Just very briefly.

The Court. I thought this was a motion for summary judgment.

Mr. Park. If your Honor may remember, when the case came up at the pre-trial I said I would like to introduce some evidence, and that I would like to have the entire case heard; and I thought it was our mutual understanding that that should be done; that is, that I should put in my evidence; and I more or less agreed with Mr. Kobrick that, while he might object to some of it, he thought it might still go in, since it would be brief, and then the material effect of it could be argued as part of the whole case. I think the argument on the motions and on the whole case with the evidence in, would be one argument.

The Court. Do you agree with Mr. Park?

Mr. Kobrick. In general, yes. I would like to add a word or two. As I understand it, Mr. Park's evidence is intended to demonstrate that the administrative hearing did not afford his client

due process of law. Our position is that that is irrelevant because of the availability of The Tax Court. Subject to the wishes of the court, if his evidence is to be brief, we might as well let him go ahead, and reserve the question of admissibility following full argument.

The Court. You both are of the view that I ought to take, subject to final ruling of law, such testimony as Mr. Park chooses to offer; that after that testimony is received you will both argue the full case, including the admissibility of the testimony, and the merits of the conflict? Is that correct?

Mr. Park. That is right.

Mr. Kobrick. I should not say that your Honor ought to hear the evidence, but we have no strong objection to proceeding in that order.

The Court. Instead of arguments on a motion for summary judgment, it is converted into a trial on the merits on the basis of the stipulation, and the testimony, if admissible, and the affidavits, subject of course to the question as to whether or not in this particular court anything may be considered beyond the certificates and the documents upon which the Government relies.

Mr. Kobrick. I would say, rather, that we would reserve our objection throughout and insist that the ruling be on the basis of the Government's motion as filed.

The Court. If I rule adversely to that, would you offer any testimony beyond the testimony which Mr. Park intends to offer?

Mr. Kobrick. None whatever.

The Court. Then, without going to the heart of the question, I am going to rule adversely to your suggestion just now made, that I ought to determine the matter upon the motion and the attached affidavits, and will determine the matter upon the basis of the papers now before me, including any pleadings, annexed pleadings, affidavits, and so forth, plus any testimony so far as legally relevant.

Mr. Kobrick. I take it that is a reservation as to your Honor's ruling as to the admissibility of his testimony.

The Court. That is correct.

Mr. Park. I venture to suggest that some of this testimony would not come within that ruling. It is merely to show the nature of the business and how it is operating. I think your Honor ought to have that picture as well.

The Court. How many witnesses have you, Mr. Park?

Mr. Park. I have two, but I will only put one on.

ALBERT I. ALEXANDER (Sworn).

*Direct Examination by Mr. PARK.*

Q. 1. What is your full name, Mr. Alexander? A. Albert I. Alexander.

Q. 2. Where do you live? A. North Andover, Mass.

Q. 3. You are the president and treasurer of Alexander Wool Combing Company, Inc., is it? A. Yes. Inc.

Q. 4. The defendant in this case? A. Yes.

Q. 5. When was that company organized? A. 1941.

Q. 6. That is a Massachusetts corporation? A. Yes, sir.

Q. 7. What is its business? A. Wool combing, principally.

Q. 8. Will you speak up just a little? A. That is wool scouring and wool combing.

Q. 9. Will you describe to the court the operations of wool combing? A. Well, we take in greased wool from the original greased wool, and sort it, and then scour it and card it and comb it and prepare it into what we call wool top.

Q. 10. What is wool top? A. Continuous strand of more or less parallel fibres of wool prepared for the spinning and weaving trades.

Q. 11. As a result of this combing process do you produce something besides wool top? A. Yes; wool noils and waste.

Q. 12. What are wool noils? A. Noils are the short fibre, after combing.

Q. 13. How short? A. Well, in the combing process the long fibre goes into top and the short fiber goes into noil, maybe from a quarter of an inch to three-quarters of an inch in length; and the average of the other long fibre may be three inches or better.

Q. 14. Wool tops, I understand, go into the worsted trade?

A. That is right.

Q. 15. Are these operations carried on on other people's wool?

A. Yes.

Q. 16. That is, you do not buy wool yourself? A. No. Strictly commission.

Q. 17. That is, you are paid on a commission basis? A. That is right.

Q. 18. Are tops and noils—is the combing process to comb them into products having the same diameter? I mean, do you comb tops into, say, 64s, 62s? A. Yes; different qualities.

Q. 19. What do those designations refer to? A. Fineness of the fibre.

Q. 20. So that when you get a lot of grease wool, do you find it all of the same diameter? A. No. When they sort, we may get 80s, 70s, 64s, 62s,—may go down to 58s, all within the same lot of wool, and many times within the same fleece, from the one animal.

Q. 21. So if you are making 64s top, for instance, from several lots of wool, you will get a certain proportion of 64s, and other proportions of wools of other diameters? A. That is right.

Q. 22. And if you are sorting from 64s—tell me this, Mr. Alexander, what is the first process in your operations? A. Sorting.

Q. 23. And what does that consist of? A. Well, we sort out the various qualities from the original lots of wool.

Q. 24. Sort them by— A. By grades.

Q. 25. By that, you mean 64s, 62s, 60s and so on? A. That is right.

Q. 26. Now, when you are given a lot of wool, are you given orders to make a certain grade of tops? A. Yes, sir. The main sort would be of one quality, and then the off sorts would be thrown out of that main sort.

Q. 27. That is, you have a main sort that consists of the grade of wool that you hope to make into tops, and then off sorts that are of other grades? A. That is right. That will later go into other qualities.



Q. 28. About what proportion usually is the main sort of the entire lot? A. It is quite variable. I would say 70 per cent may be the average.

Q. 29. What is the next operation after sorting? A. Scouring. That is a washing process.

Q. 30. And what is the purpose of that? A. Well, it removes all the grease and dirt and impurities. In other words, the dirt, the same as a laundry process.

Q. 31. And as a result of that scouring process, does the wool shrink, as they say in your trade? A. Yes, sir.

Q. 32. And what does the shrinkage mean? A. Well, the shrink is what is missing after the washing process. If we start with 100 pounds, we may have 20 to 40 pounds of wool left, and the rest of it represents dirt and grease from the animal.

Q. 33. Does that vary greatly by the origin of the wool? A. Yes; depending largely on the country of origin.

Q. 34. What is the next process after scouring? A. It is the carding process.

Q. 35. What does carding consist of? A. Well, it opens it up and separates the fibres, and puts them into a continuous strand, in preparation for combing.

Q. 36. And is combing the last process? A. Combing is the last process.

Q. 37. And that is the process in which the tops are separated from the noils? A. That is right.

Q. 38. And how is the combing process effected? What is done? Do you have machinery? A. Yes. We use combs. In our case Noble combs that mechanically separate the long fibre from the short fibre.

Q. 39. In the combing process and in the other processes that precede it, is there a certain amount of waste? A. Yes.

Q. 40. Roughly, out of 100 pounds of wool, how much was apt to be waste? A. Oh, that is another quite variable. Maybe 4 or 5 per cent of waste. That does not include noil. Noil may be as high as 20 per cent.

Q. 41. What are the usual limits for the production of noils?

A. Well, there isn't much control. I mean, it depends on the wool; I mean, how much short is in it. The wool really controls the amount of noil.

Q. 42. I understand that, but what percentage of the clean wool after scouring would you normally expect to make into top and what per cent into noil? A. Maybe 18 or 20 as noil and the balance top. That is on a clean basis.

Q. 43. And is some fraction of that also waste? A. Yes. You would still have a fraction of waste from the cards, from the combs and the washing.

Q. 44. So that if you started off with a thousand pounds of grease wool, you would expect that to sort—and you were trying to make 64s, you would expect that to sort first to some proportion of that which you term the main sort? A. That is right.

Q. 45. Which might be 70 per cent or 80 per cent? A. That is right.

Q. 46. And that wool which was then left in the main sort would be scoured? A. That is right.

Q. 47. What would happen to the off sorts? A. Well, they would just be accumulated, to run in some future combing of a like quality.

Q. 48. And after scouring, that wool might shrink 50 per cent or more? A. That is right.

Q. 49. And it would then be combed into—carded and then combed into top and noils in proportions of say 80 per cent? A. And 20.

Q. 50. Perhaps top, something more or less, and 16 to 20 per cent noils? A. That is right.

Q. 51. And 4 to 5 per cent waste? A. Well, yes. Probably 2 per cent on that clean basis.

Q. 52. Prior to your becoming an officer of Alexander Wool Combing Company, what experience had you had in connection with the business of combing wool? A. Well, I operated Pacific Mills combing plant for a good many years.

Q. 53. I think you might speak up a little more, Mr. Alexander. A. I operated Pacific Mills combing plant for a good many years. Of course I was employed by other concerns.

Q. 54. How long did you operate the plant at Pacific Mills?

A. Well, the combing department probably six years.

Q. 55. And what was your office there? A. General overseer.

Q. 56. And prior to that, had you been connected with the combing plants? A. Not in combing; but I have had various mills with combing plants.

Q. 57. Has most of your life been spent in— A. Well, related processes, up to weaving.

Q. 58. The Pacific Mills was an integrated mill? A. That is right.

Q. 59. Which conducted various operations? A. Yes.

Q. 60. That is, combing and the other operations that follow it? A. That is right.

Q. 61. What are the other operations that follow it? A. Drawing and spinning, winding, twisting, weaving. In the period of fourteen years at Pacific Mills at one time or another I controlled all the processes up to weaving. I spent six or seven years in combing alone, but previous to that I had had both English drawing and French drawing and mule spinning and winding and twisting, and these various processes you have mentioned.

Q. 62. And did you in the course of your experience become acquainted with other combers and other persons in the wool textile business? A. Yes.

Q. 63. And acquired some familiarity with the business? A. Yes.

Q. 64. In the combing business is there some general division between types of combers? A. Well, there is a type of comber that combs on commission, and the type that combs for their own accounts; and some do both.

Q. 65. That is, there are commission combers and persons who comb their own wool for their own use? A. That is right.

Q. 66. And others who do both? A. That is right.

Q. 67. Has the business of commission combing developed and increased in recent years to your knowledge? A. Yes; it has.

Q. 68. And were you familiar in 1941 with the charges which

other commission combers were making? A. Yes, I was to some extent.

Q. 69. When did your company actually start operations? A. In October, 1941.

Q. 70. Was it an enterprise that you had planned for a number of years? A. Yes; it was.

Q. 71. At the time when you commenced operations did you establish rates for the commissions that you were to charge? A. Yes; I did.

Q. 72. And did you do that after making yourself familiar with rates charged by other commission combers? A. Yes. I knew generally what other combers were charging, and we established what we thought was a fair rate for combing.

Q. 73. Were your rates substantially the going rates? A. Yes, sir.

Q. 74. That is, do commission combers fix their charges in various ways? A. Yes; they do.

Q. 75. But the final result is substantially the same? A. About the same cost to a top maker.

Q. 76. Have you ever increased your rates? A. No, sir.

Q. 77. Were they frozen by the general maximum price regulation? A. Yes; they were.

Q. 78. In your opinion were your rates the fair going rates? A. Yes; they were.

Q. 79. The fiscal year of your company ends on June 30th? A. Yes.

Q. 80. Did you at any time during the fiscal years ending June 30, 1942, or June 30, 1943, have any direct contracts with any department of the United States? A. No.

Q. 81. Or any Government agency? A. No.

Q. 82. To whom did you sell or render services? A. To independent customers.

Q. 83. Well, what class of customers? A. Top makers.

Q. 84. Principally Nichols & Company, Inc.? A. That is right.

Q. 85. Is that a very large top maker? A. That is, I understand, the largest in the world.



Q. 86. Did your company do all of the combing of Nichols & Company, Inc.? A. No; we just did a fraction.

Q. 87. A comparatively small fraction? A. Yes; very small amount.

The Court. Do I understand, in your relations with Nichols & Company, Inc., it was their wool that you combed?

The Witness. That is right.

The Court. It was not yours?

The Witness. Not our wool at all. We did not own it at all.

The Court. You performed a service in connection with the conditioning of the wool for later sale by Nichols & Company, Inc.?

The Witness. That is right. Nichols and others. They are the principal customer.

Q. 88. You also did work for some other top makers? A. Yes; we did scouring for some others.

Q. 89. For the American Woolen Company, for instance? A. Yes.

The Court. Did you do it pursuant to a formal written contract or not?

The Witness. No, sir. We never had any formal contract.

The Court. Never had any formal contract either with Nichols & Company, Inc., or with any other top makers?

The Witness. No.

The Court. How did you make arrangements for payments? [To Mr. Park.] Or are you going to cover that?

Mr. Park. I was just about to ask him.

The Court. All right. Fine.

Q. 90. That is, you received orders to comb certain wool? A. We did.

Q. 91. And the lots of wool would be shipped to you? A. That is right.

Q. 92. Did you render bills weekly? A. Yes, we did.

Q. 93. To Nichols & Company? A. Yes.

Q. 94. And to your other customers as well?

The Court. May I interrupt? How long does the combing

process take? If you received a shipment on Monday, when would you return it?

The Witness. At that time we may have produced 50,000 a week. One lot might be 500,000. That would be ten weeks or more in the process of completing one lot.

The Court. It might take as long as ten weeks to complete a lot?

The Witness. That is right.

The Court. When the lot was shipped to you, was it identified in some way by invoices to Nichols & Company?

The Witness. Oh, yes; we had weight sheets, and so forth.

The Court. When did you send a bill for the work?

The Witness. Each Monday we sent them a bill for the work we did the previous week, on account.

The Court. How did you arrive at the prices?

The Witness. Well, we had a flat price, the amount of pounds we comb, and then subject to correction at the completion of the combing.

The Court. Was there an over-all contract between you and Nichols & Company as to what rate you would charge?

The Witness. No. We only do fine combing, and the price has always been one price for the same thing. We only have one price.

The Court. Where would I find that price if I were a customer and wanted to find out about it?

The Witness. Well, you would probably call up and ask the mill the price.

The Court. Ask you?

The Witness. Yes.

The Court. Did somebody from Nichols & Company, Inc., ask you what the prices would be if they sent you from time to time wool?

The Witness. Yes.

The Court. When was that conversation?

The Witness. Oh, probably in October or so.

The Court. October, 1941?

The Witness. Yes.

The Court. And did you say that if they sent you wool, you would charge them at such and such rates?

The Witness. Yes, sir.

The Court. So there was an over-all understanding between you and Nichols & Company, Inc., as to what rates you would charge?

The Witness. That is right.

The Court. And every time they sent you a lot, they anticipated that you would charge at a certain rate which was discussed in October, 1941, you expected to charge at that rate, and you did charge at that rate?

The Witness. That is right.

Q. 95. Originally I suppose it was anticipated that the rates might change? A. Yes.

Q. 96. But when the general maximum price regulation froze the rates, there was no further discussion of rates? A. We still charge the same rates today.

The Court. And what happened with Nichols & Company, Inc., happened with your other customers?

The Witness. That is right.

The Court. There was more or less general discussion as to what you would charge, the rates were frozen by the OPA, and from time to time you would bill your customer on the basis of your conversation and the OPA regulations?

The Witness. That is right.

Q. 97. None of these orders that were given you contained anything about renegotiation, did they? A. No, sir.

Q. 98. Was any order ever given you for a sum in excess of \$100,000? A. No, sir.

The Court. Could you tell by looking at these invoices or documents you received from Nichols & Company, Inc., who was going to be the ultimate user of the wool?

The Witness. No, sir.

The Court. Was there any name other than Nichols & Company, Inc.,—on the wool?

The Witness. From the countries of origin, they had all sorts

of names, as to who originally owned the sheep. There may be five bales in one name. Out of a thousand bales there may be fifty or one hundred names.

The Court: The source of the wool might sometimes be indicated?

The Witness. Yes; that is right.

The Court. But was the destination of the wool after it left Nichols & Company, Inc., ever indicated on the invoices received?

The Witness. No, sir; not on the invoices.

Q. 99. Did you ever receive instructions from Nichols & Company as to ultimate destination? A. We received shipping instructions.

Q. 100. That is, after wool was combed you received instructions to ship to some customer of Nichols & Company? A. That is right.

Q. 101. So a large part of the wool, at least you knew at some time before the wool left you, its ultimate destination? A. That is right.

Q. 102. Did you always know that? A. Not always. Generally speaking.

The Court. Did you know in four-fifths of the cases?

The Witness. Yes; more than that; but occasionally we would deliver to a trucking concern a certain amount of wool that we did not know at that time its destination.

Q. 103. And perhaps never knew? A. Probably never knew.

Q. 104. That was a comparatively small fraction? A. Yes.

Q. 105. As much as 10 per cent? A. No. I would say less than 5.

Q. 106. Most of the time you knew at some time the ultimate destination? A. Yes.

Q. 107. Was that usually after the work was done? A. Usually after the lot was combed or in the process of combing.

Q. 108. Did you know what use these consignees intended to make of the tops or noils or what ever it might be, that you shipped? A. No; we never knew.

Q. 109. You were aware, weren't you, that in the spring of 1942



and the rest of 1942 and early 1943, the end use of many of these products was for the performance of some contract with the Government? A. Yes; we knew that.

The Court. Did you at one time certify that the entire production of wool top from Alexander Wool Combing Company was "for United States Army and United States Navy fabric"?

The Witness. Yes; that is right.

The Court. Did you make that certificate with respect to shipments beginning in April, 1942?

The Witness. I should think so, yes.

The Court. So you once certified that you knew all your production was going to the United States Army and United States Navy fabrics, didn't you?

The Witness. That is right.

The Court. Was that a correct certificate?

The Witness. Yes.

Q. 110. Well, was it a correct certificate? A. At that time we believed it was all going in. Later we found out that certain combings did not meet approval, and then the tops and noils division, the noils went entirely into civilian work.

Q. 111. During that period did you understand that the grades of wool that the Government was taking were 64s and 62s? A. That is right.

Q. 112. And your main work was in producing 64s and 62s during that period? A. Yes.

Q. 113. At the same time, in producing 64s and 62s, you had to take out the off sorts? A. That is right.

Q. 114. And those were all other grades which you— A. We processed, that the Government did not take, but in order to get the part that they wanted, we put through a lot of wool that, you may say, for instance, there would be 70 per cent of it that was of a suitable quality. The other qualities that we took out were also processed, and probably did not go into Government work.

Q. 115. When you made the certificate to which the court referred, did you have in mind a production of 64s and 62s as your main function? A. That is right.

Q. 116. And when you stated that 100 per cent of your product was going into war use, from whom did you receive the information? A. Customers, principally.

Q. 117. Did you know whether— Your own customers? A. Yes; and the general trade. I knew that the Army were taking all that quality that could be obtained.

Q. 118. And your certificate was based upon that general information that you had received from your own customers, and what you heard in the trade, that the Army was taking all the 64s and 62s? A. That is right.

Q. 119. Did you know at the time you combed wool for Nichols & Company that it had specific contracts to which it was going to allot the tops or noils that you produced? A. No; we did not.

Q. 120. Well, did you know whether the customers of Nichols & Company to whom you shipped top or noils, had contracts with the Government? A. No; we did not.

Q. 121. But you expected that at some time wool would flow in, in large part, into the use and performance of Government contracts? A. Yes; we thought it would eventually turn into Army and Navy cloth.

Q. 122. Do you know whether some 64s and 62s were in fact used for civilian use during that period, that is, up to June 30, 1943? A. Well, I would not be sure.

Q. 123. Do you know whether firms that do these operations that succeed, that is, drawing, spinning, weaving, and so on, maintain and keep stocks of tops and noils? A. They do keep stocks.

Q. 124. And is there any reason why top which you produced could not be substituted for top produced by somebody else, if it were of the same grade and general qualities? A. No reason.

Q. 125. Did you know whether tops could be accepted for use in Government contracts until they had been inspected by inspectors from the War Department, if it was to be used for a War Department contract? A. When we produced the top, we did not know whether it would meet Government specifications. It was later submitted to the Quartermaster's Corps.

Q. 126. For inspection? A. For inspection.

Q. 127. Did you as part of your service furnish samples of top for such inspection and for inspection by buyers? A. We did.

Q. 128. That is, of every lot of top you furnished a sample? A. That is right.

Q. 129. For those purposes? A. Yes.

Q. 130. And when was that sample furnished, during the course of the combing or the end of it? A. At the start of the lot we furnished samples to Nichols.

Q. 131. Which they might later submit to customers? A. That is right. Every lot of tops had to be certified for use in Government fabrics at some later date.

Q. 132. When was that certification made? A. Well, maybe in the course of the combing, or after the combing.

Q. 133. And were you notified of it or not? A. No; we never were.

Q. 134. That is, certification was given Nichols & Company? A. That is right.

Q. 135. And I think you said you performed only a fraction of the combing which Nichols & Company required? A. Yes.

Q. 136. What was your capacity in terms of top per week, say? A. Well, it varied from the time we started, from probably 10,000 pounds to probably—when we got up to capacity, maybe 70,000.

Q. 137. Per week? A. 60,000 or 70,000 pounds per week.

Q. 138. How many combs did you have? A. Twelve combs.

Q. 139. Do you know roughly how many there are in the country? Are there accurate records of that? A. I can say there are more than 2000 of the type of comb. That does not include a French comb, similar comb, used in the process. That is only Noble's combs.

Q. 140. That is the kind of comb that your company operates? A. That is right.

Q. 141. During this period from October, 1941, after you established your rates, until June 30, 1943, did your combing costs increase? A. Yes; they did very much.

Q. 142. Due to what factors? A. Well, principally labor costs, and rent, costs of material, power, light.

Q. 143. At some time, Mr. Alexander, did you have a meeting with representatives of the Boston Quartermaster Price Adjustment District Office? A. Yes; we did.

Q. 144. And was that for the purpose of discussing renegotiation of your contracts? A. Yes.

Q. 145. Do you recall whether there were two meetings before the close of your fiscal year, June 30, 1943? A. I believe there were.

Q. 146. And does it accord with your recollection that those meetings were on June 10th and June 26th, 1943? A. Yes.

Q. 147. Where was this meeting? A. In Boston, here; Quartermaster's.

Q. 148. Do you remember the address? No. 1 State Street?  
A. 1 State Street.

Q. 149. Do you recall who were present at those meetings? A. Well, Ostrander, for one, and an auditor. I could not tell you the auditor's name.

Q. 150. By Ostrander, you refer to— A. Lieutenant Ostrander.

Q. 151. Now Major Ostrander? A. Yes, sir.

Q. 152. And Mr. Allen? A. Mr. Allen is right.

Q. 153. Will you describe briefly the proceedings that took place? A. Well, we were asked to submit certain figures of total sales and profits; how much we made on various items.

Q. 154. Well, after that, what happened? You submitted the information that was called for? A. Yes, sir.

Q. 155. Was there any discussion about it? A. Well, we didn't have—we submitted exactly what they wanted, and every item was as they wanted it; not as we wanted to figure it, but as they wanted to figure it.

Q. 156. Do you remember any discussion about whether or not Alexander Wool Combing Company was a subcontractor? A. Yes. We at one time talked to Mr. Allen and thought we had an agreement with Mr. Allen that we were not subject to it, and Lieutenant Ostrander insisted that we were.

The Court. I do not want to interfere with your orderly exami-



nation, Mr. Park, but I cannot see what the views of those men have to do with the case at all.

Mr. Park. As a matter of fact, all I wanted to bring out—and perhaps I can put it into his mouth—is that there was some discussion on this end use question, and the company took the position that ultimate end use—that is a little tautological—that the ultimate use did not necessarily determine as to whether or not you were a subcontractor.

The Witness. Yes, sir.

Q. 157. Do you remember that, Mr. Alexander? A. Yes, sir.

Q. 158. And you were asked to submit letters from your customers as to what percentage they estimated of their business was subject to negotiation? A. Yes.

Q. 159. And you did that? A. Yes, sir.

Q. 160. And on the basis of that, Lieutenant Ostrander and his associates made a segregation and estimate of what part of your business ultimately went into the performance of Government contracts? A. That is right.

Q. 161. Did you agree to that? A. No; we did not.

The Court. How much more do you want to bring out from this witness?

Mr. Park. Does your Honor think I ought to submit an affidavit? I really wanted to put in through this witness this account of what his business is like; and that is in. Now, as to these conferences with the representatives of the War Department on price adjustment, I am frank to say I only want to raise certain points, and perhaps the shortest way would be to put an affidavit in, which covers merely the facts I have stated in my brief. Those you do not want to dispute anyway, do you?

The Court. I haven't any doubt that the position of Mr. Kobrick is that your statement of the facts is entirely correct but generally irrelevant.

Mr. Kobrick. That is substantially so.

Mr. Park. You have read my brief?

Mr. Kobrick. That is substantially accurate.

The Court. It is agreed, is it, that Mr. Park will submit an

affidavit which on the whole will correspond with what is stated in his brief, describing certain functions; that the Government will raise no objection to the form, in the sense that he has presented an affidavit instead of a witness stating the facts on the witness stand, but that the Government regards the facts as irrelevant and submits the question to the court for ruling of law?

Mr. Kobrick. That is entirely correct, your Honor. In the event that the affidavit is deemed relevant, we should like the right to examine the affidavit itself. I suppose that is unnecessary with the qualifications you have already put in, that it corresponds in substance with the statements in the brief. Those are correct in general.

The Court. Then the court rules that in this case the defendant may in 48 hours—

Mr. Park. I will do it right away.

The Court. All right. Show the affidavit to Mr. Kobrick.

Mr. Park. Mr. Alexander has signed it and sworn to it; but I forgot to put my name on it.

The Court. There being no objection, the following procedure will be followed: The affidavit of Albert I. Alexander will be received by the court in the same way as statements would be received if Alexander had made the statements on the stand under oath. In short, no objection will be raised or allowed to the form in which the testimony is presented. The court, however, reserves its ruling of law as to the relevance of the matters covered in the affidavit.

Mr. Park. Yes, sir. Well then, I will have no further questions of Mr. Alexander.

The Court. Have you any questions, Mr. Kobrick?

Mr. Kobrick. I have no questions, your Honor.

The Court. All right. You are excused.

Mr. Kobrick. Is it in order now to proceed with the argument on the Government's motion?

The Court. As far as I am concerned, that is the only thing left. Do you want the argument transcribed by the reporter?

Mr. Park. I would like it. I have some documents, of which

I think your Honor could take judicial notice. It seems to me it would be as well to do that in the course of the argument, when they are appropriate, rather than attempt to do it before—

The Court. What are the documents? State them briefly.

Mr. Park. Statement by Under Secretary of War Patterson, or certain portions of his testimony.

The Court. Before a congressional committee?

Mr. Park. Before a congressional committee.

The Court. You are content that I should take judicial notice of that statement?

Mr. Kobrick. Indeed we are, your Honor.

Mr. Park. And a report of the Committee on Naval Affairs which was submitted to Congress. These matters did not come to my attention until Saturday morning. I tried to reach Mr. Kobrick, but found he was out, and wrote him.

The Court. I am sure Mr. Kobrick is quite content that the court should take judicial notice of a report of any Senatorial Committee or House Committee on Naval Affairs that may be relevant.

Mr. Kobrick. That is correct.

Mr. Park. The only other matter is a statement of considerations issued by the Office of Price Administration in support of Revised Price Schedule No. 58.

The Court. That being a regulation adopted under authority of the Emergency Price Control Act, the court has the same power to consider that as any statute or regulation adopted pursuant to any statute; and I shall take judicial notice.

Mr. Park. I might as well read that now. It is rather short.

The Court. Oh, you don't need to read it.

Mr. Kobrick. May it please the court, it probably is unnecessary to repeat, but I will just state that the case is here on motion for summary judgment and judgment on the pleadings. It probably is also unnecessary to go over the provisions of the statute or detail the facts of the case so far as the facts are important for the consideration of these motions.

The Court. Is it your view that the moment the certificate is served upon a company, the United States may bring a suit upon

the certificate in the District Court, and the District Court has no authority to inquire into anything except, was a determination issued and served?

Mr. Kobrick. I think, your Honor, that the statute makes that rather clear.

The Court. I am just asking you if that is your view.

Mr. Kobrick. That is, your Honor. I think that is the Government's position.

The Court. So I am not concerned as to whether the company is engaged in war work, is a subcontractor, is a charitable organization, and so on. All I have to consider is: Was a determination made by the secretary? Was it served? And I am limited to determining the amount?

Mr. Kobrick. I suppose a defense would be payment, but beyond that—

The Court. Oh, of course.

Mr. Kobrick. The principal defense is the alleged unconstitutionality of the statute itself.

The Court. Can't I consider that?

Mr. Kobrick. I personally might have had some doubt as to whether that could be considered without a contractor first applying to The Tax Court for a final administrative determination.

The Court. Supposing the defendant was prepared to show that the president of the United States never signed the Act, and it was never passed over his veto. Wouldn't he be able to show that?

Mr. Kobrick. I should think so.

The Court. Wouldn't he be able to show that the statute was unconstitutional in the sense that it singled out for renegotiation companies whose names began with A, but not companies whose names began with B?

Mr. Kobrick. I think he could.

The Court. In other words, there are certain types of unconstitutionality that could be raised in this proceeding?

Mr. Kobrick. I think so, your Honor.



The Court. You do not go so far as to say that the question of constitutionality of this statute is beyond the court?

Mr. Kobrick. In general I think that is so, with the qualification that there are certain questions that it is impossible to consider, beyond The Tax Court.

The primary contentions made by the defendant other than constitutional questions are: First, that the administrative proceeding was inadequate to afford due process. That is predicated chiefly on the fact, which we admit, that the renegotiating officials had available to them figures, prices and costs of other wool combers, which came to them in the course of carrying on similar renegotiating proceedings with those other wool combers. The defendant specifically requested that that information be disclosed, and that request was denied, and is denied in every single renegotiation case, on the ground that every contractor who engages in a renegotiation proceeding with the Government is entitled to have information which he submits relating to his own business treated in confidence, not made public.

The Court. Whether or not that contention is or is not correct, I suppose you regard that as a question as to admissibility of evidence, and in your view that would have to be raised in a tactical way?

Mr. Kobrick. Yes, indeed, your Honor. But there is a much stronger reason, I think, for considering this whole question irrelevant. A tax court proceeding is a *de novo* proceeding, so whatever has gone before does not prejudice in any way the rights of the contractor, and The Tax Court procedure themselves, I think, are beyond all questions—

The Court. Except upon review?

Mr. Kobrick. Procedurally, there can be no attack on a tax court proceeding. Certainly The Tax Court has been corrected many times. Before I arrive at this point, I should like to draw attention to a renegotiation case decided by a three-judge statutory court in the District of Columbia some months ago, in which this same contention was made with respect to administrative hearing, that it failed to afford the defendant due process of law.

That is Aircraft & Diesel Equipment Corporation *v.* Hirsch. And the court answered that question with this statement:

"So far as the administrative procedure is concerned, any defects in the hearing before the War Contracts Price Adjustment Board are immaterial so long as the plaintiff obtains a full hearing before The Tax Court of the United States."

[Page 67 of Government's opening brief.]

The Court. What is the official citation of that?

Mr. Kobrick. I will have to supply that later.

The Court. No, you won't. I can find it.

Mr. Kobrick. The other question, apart from constitutionality, which the defendant has raised is that at least some of the business which was included by the War Department in the renegotiation proceeding ought not to have been included because it was not covered by the statute properly interpreted. The contention in substance is that nothing can be a subcontract unless it can be shown to relate to a prime contract which antedated the so-called subcontract. The War Department has always taken the view that the relative timing of the transactions is immaterial, and that they should be concerned exclusively with the question of actual end use.

The Court. That is a question of coverage?

Mr. Kobrick. Precisely. I think your Honor may well be holding the opinion that I was about to mention, the Waterman case.

The Court. I was.

Mr. Kobrick. It becomes unnecessary for me to go further with this point. It seems to me that the single sentence midway—

The Court. "We think the language shows The Tax Court has such power?"

Mr. Kobrick. Exactly. The precise contention was rejected by the Supreme Court. So I say that under the authorities which we have just been talking about, and the many cases set forth in the Government's brief, the administrative determination is not open to attack and has become final through the failure of a tax court review. There is one minor point remaining before I come to

the substantive questions as to constitutionality, and that is the provision in the statute precluding official review of tax court decisions as unconstitutional. And I think it is implied at least by the defendant that if that be true he is excused from resorting to The Tax Court and may open all the questions here which would be otherwise open in The Tax Court. I think that contention is answered in a single opinion by the Supreme Court of the United States, in the case of *First National Bank v. Weld County*, referred to on page 10 of the reply brief; and the particular statement of the court bearing on this question is as follows:

"It is urged further that it would have been futile to seek a hearing before the State Tax Commission, because, first, no appeal to a judicial tribunal was provided in the event of a rejection of a taxpayer's complaint; and, second, because the time at the disposal of the Commission for hearing individual complaints was inadequate. But, aside from the fact that such an appeal is not a matter of right, but wholly defendant [*sic*] upon statute, we cannot assume that if application had been made to the Commission, proper relief would not have been accorded by that body, in view of its statutory authority to receive complaints and examine into all cases where it is alleged that property has been fraudulently, improperly or unfairly assessed."

The Court. I haven't read the case of *First National Bank* against *Weld County*, but am I wrong in the impression I get from the language, that it is doubtful whether you can seek judicial review without having first exhausted your administrative remedy?

Mr. Kobrick. The situation there was that an attempt was made to recover back the tax. The defense was that administrative remedy had not been exhausted; but, as here, it was too late. The time had run for appeal. The contention was made that there was an excuse for that failure, on the ground that no appeal was permitted to any court from the decision of the tax administrator.

The Court. Isn't the problem as presented in this case some-

what different? Here you have not got the question of exercising taxing power. It is exercise of a different power, whatever it may be.

Mr. Kobrick. We say the war power; and I think it is important what it is, if we are right. If this is an exercise of the war power, and a proper exercise of the war power, we think the Government is entitled to all the power which the tax power permits. I do not suppose it has ever been held that the war power is narrower for any purpose than the taxing power.

The Court. Supposing the Emergency Price Control Act authorized the administrative official to make a determination under this power, and provided for no judicial review of his determination. That is not the situation. Let's assume that he set the price at which you could sell eggs at 10 cents a dozen and there was no judicial review of that method of setting the price, which in my hypothesis is a confiscatory price.

Mr. Kobrick. I would like to take two things there separately. I would like to suggest that the analogy you draw would be comparable to a provision in this statute eliminating The Tax Court review entirely, and providing that the Secretary of War shall have final authority to define excessive profits. That is not this case. I think it is important for this reason. In each of these cases, the one your Honor put and the one I put, the administrative official is also the final arbiter. That may offend the due process. I think it may be quite different when the final arbiter is an impartial tribunal, providing its decisions are fair and its impartiality is assured.

The Court. It has been thought that a public utility rate may not be finally fixed by an administrative tribunal without opportunity of judicial review. It has been thought that if you fix a rate so low that it is a denial of a fair return upon property, there is a right to judicial review. There is a trend the other way.

Mr. Kobrick. That is the other problem. We have not reached such problem in any case I know about. But it seems to me that if a contractor, having applied to a tax court, and having had a final order in that forum, has a complaint at that point that the



administrative order is confiscatory, that is, that it reduces his profit to so low a point that he does not receive a fair return on his investment—I want to distinguish that from the eminent domain problem which I will talk of later—if that be the contention, it seems to me that there is nothing in the renegotiation act which precludes consideration of that claim of constitutional right in a constitutional court, such as this one. Suppose we translate this in terms of Alexander, and say, "If he had applied to The Tax Court and The Tax Court had arrived at some determination as to amount of excessive profits, in this proceeding I suppose it would be proper for the court to consider the question whether the claim of confiscation is made out."

The Court. Do I understand your contention to be that Alexander can raise his question of confiscation in a suit upon judgment of The Tax Court, but cannot in a suit upon a determination by the secretary of war?

Mr. Kobrick. Precisely.

The Court. What is the difference?

Mr. Kobrick. I think there is a substantial basis, in this way. I might add that so far as I know, no such contention could be or is made here, in view of the figures. They are not in the records. Discussing this as an abstract question—

The Court. I did not think it was quite so abstract. And I do not care to discuss an abstract question. But I had thought the point was raised that the procedure in The Tax Court was an unconstitutional procedure in that it denied judicial hearing on the question of confiscation. I may have misunderstood.

Mr. Kobrick. I did not so understand. I thought the contention was made that if judicial determination of fair market value for the purposes of taking was the principal complaint, and that this contention also was resorted to for purposes of excusing failure to resort to tax court procedure—but I would like to come back to the differentiation between a tax court order and War Department order.

The Court. I see you correctly use the phrase "Tax Court order" where I used "Tax Court judgment".

Mr. Kobrick. This statute has some such language as "order", your Honor.

The Court. It is not, strictly speaking, a judgment.

Mr. Kobrick. It is not a judgment. The statute was designed by Congress to operate in this specified manner. The War Department in the first instance makes an effort to agree with the contractor, and in nearly all the cases that is the way the matter ends. I think the figure is something like 97 per cent. If there is no agreement, an order is entered by the War Department. If the contractor is dissatisfied with that result—

The Court. You said "order". Strictly speaking, that is a determination?

Mr. Kobrick. You may be right about that. I think it is called both administratively. I am not sure the statute has it in those terms. The contractor then is entitled to have the entire matter heard *de novo* by The Tax Court.

The Court. Within 90 days after the service of the determination.

Mr. Kobrick. Within 90 days. In the case of the 1942 determination, it is within 90 days after the determination and notice thereon.

The Court. That 90-day period had elapsed when this suit was brought by the United States.

Mr. Kobrick. It had, and that was not an accident.

The Court. Is it your view that you cannot proceed until the 90 days have elapsed, or are you trying to avoid a case in which that question is presented?

Mr. Kobrick. We have filed such cases where we had doubts as to solvency. We have more than enough to do to keep up with the others. The power of the Federal District Court is a narrow power in such cases. It cannot correct of its own motion, or remand for administrative correction. So a contention allowed against the War Department order may give the contractor more than he is entitled to. If we assume the War Department made a mistake of serious character, we may also assume The Tax Court would have corrected that mistake, and in that tribunal there

would have been an opportunity for the Government to have an order entered.

The Court. If I accepted the contentions of the defendant, I would merely enter judgment for the defendant without prejudice to a new determination by the plaintiff, and new proceeding by the plaintiff on the new determination?

Mr. Kobrick. The statute does not permit another administrative proceeding. Specific statutes of limitations were written in, which preclude proceedings commenced after a specified date, which has long since run here. I know of no power, unless it be on the theory that the administrative proceeding is never closed until the judgment of the court is entered. That seems to me to be a bit far-fetched. I think administrative determination is closed with the War Department's order. This same consideration cuts across every attack. The contractor is asking for more than simple justice. He is asking for immunity.

The Court. In your view, is this like a suit which might be brought on an award of the Interstate Commerce Commission in a rate proceeding, in which the respondent is allowed to question proceedings before the Commission, and the only question presented to the court is whether the Interstate Commerce Commission entered such a return order, and whether it was passed?

Mr. Kobrick. Your Honor, I think some of those cases were cited in our brief.

The Court. And they were cited before the Supreme Court for the same question that you cite them on?

Mr. Kobrick. Precisely. I think the only question on the Yakus case left open was whether the statute was an authorized statute by Congress.

The Court. At least this court and the Supreme Court intended to leave open another question, as to whether the administrative determination on its face was unconstitutional. If, for example, a determination began with recitals stating that, whereas A had voted for a Republican candidate for president, "We determine that such and such an amount should be paid", I assume you

would take the position that that decision was unconstitutional on its face.

Mr. Kobrick. I could agree with your Honor if I was certain as to what was meant by "unconstitutional on its face". In the illustration your Honor has given, I should agree. I will now come to the substantive contentions. The principal objection is the objection that this is a taking.

The Court. You don't have to spend very long on that, because at the moment I do not understand how it can be considered as exercise of the power of eminent domain. To me it is apparent that it is an exercise of regulatory power.

Mr. Kobrick. With respect to the last suggestion you dropped, I suppose that the Dayton-Goose Creek case is as close an analogy as one could expect to find.

The Court. There is another one, isn't there, in which there is power in the income tax authorities to reassess a tax in the light of certain administrative matters?

Mr. Kobrick. Is this a Federal statute your Honor is referring to?

The Court. Yes. The Supreme Court of the United States held that the Commissioner of Internal Revenue could be given power to recompute taxes in the light of certain considerations.

Mr. Kobrick. Oh, yes. That statute was passed after the last war. The cases in the Supreme Court are Williamsport Wire Rope, and I think Diamond Alkali. I might add that Mr. Justice Brandeis' opinion in that case seems to me to support the procedural argument I made a few minutes ago,—two aspects of it: first, as to the War Department procedures, the policy of refusing to make known information with respect to others. On that question Mr. Justice Brandeis pointed out at some length that The Tax Court, where review would be permitted of the commissioner's special assessment, then the Board of Tax Appeals of course—had a great deal of information about comparable corporations because it had considered those questions. That seems to me to be directly parallel to the War Department situation. The second point was that judicial review of the Board of Tax Appeals' deci-



sions was denied solely on the strength of an interpretation of the statute which required uniform treatment, the theory of the Supreme Court being that if appeals were permitted throughout the various Federal courts the entire objective of uniformity would be destroyed. So without aid of specific Congressional enactment; in that case, it was decided that there is no due process objection in proper circumstances to cutting off a proceeding short of a constitutional court. On the question of regulation, I have mentioned the Dayton-Goose Creek case, your Honor has reminded me of the Williamsport Wire Rope case. I should like to spend some time now on the attack on the basis of delegation of legislative authority.

The Court. Is this the exercise of legislative or proprietary power?

Mr. Kobrick. We say, your Honor, that the power is legislative.

The Court. Because this is a subcontract?

Mr. Kobrick. We would suggest that would be true in all cases. Renegotiation is not a modification of the contract. The statute, as applied, contemplates annual review of overall war business, and the legislative history of the statute makes it clear that while the dollars were of great importance, the morale problems deeply concerned Congress as well, both at home and on the fronts. And it has always been the view of the Government in these cases that the power is not strictly speaking proprietary power; that the regulatory power is applied in a field in which the Government has a large direct interest, but nevertheless it is regulation. The question of delegation revolves around the contention that the word "excessive" is not a sufficient standard for administrative guidance.

The Court. It is at least as clear a standard as appears in the Emergency Price Control Act, isn't it?

Mr. Kobrick. We think so, and have cited a great number of cases in our brief, decisions of the Supreme Court which fall into three major categories, in which this same general type of contention was made and rejected.

The Court. As far as we know, the highest court of the United

States has in only two cases upheld the objection to a delegation of power which was invalid under the constitution, those two cases having been decided at a particular time which makes them somewhat debatable.

Mr. Kobrick. Even if we should accept those as having some vitality at the present moment, I think they are distinguishable from this case.

The Court. There was a case in which Mr. Charles E. Hughes as counsel persuaded the court that there was not an adequate definition of a crime.

Mr. Kobrick. That they were too vague. That same line of cases includes some civil as well as criminal cases. The contractor had to decide for himself on pain of illegality as to whether he was offered a proper price. There are all the cases in which the standard of "necessary", for example, is questioned. McKinley against the United States is such a case.

The Court. Well, a fair and reasonable rate. That is not very helpful, is it? I mean, it is not any more helpful to a commission than "excessive" is to the secretary of war.

Mr. Kobrick. Exactly. We say that the one is the obverse of the other. And there are the statutes which provide that decisions should be made "in the public interest". I might make one further point on this question of delegation,—that in any event there has been sufficient ratification of adopted standards within the doctrine of the Hirabayashi case.

The Court. I don't know about that. It seems to me that that case makes it plain that the specific orders of General DeWitt had been brought to the attention of Congress; and having ratified them, they did so with knowledge of General DeWitt's orders. Do you say there is anything like that in this case?

Mr. Kobrick. I will say that there was probably a much more serious problem in the Hirabayashi case, but after the statute was passed, the War Department issued a release to the business community which set out at some length its views as to how it would fix profits.

The Court. Was that also adopted by the "other departments"?

Mr. Kobrick. The joint release came at a later date. The War Department was most active in this field, because it had by far the predominant interest. The original release was exclusively a War Department statement. It came out in 1942. The statute had been in effect but a very few months. It was put before the various committees of Congress without considering the October, 1942, amendments. So it was fully informed. I think to that extent the parallel was there.

The Court. Do I understand it was actually drawn to the attention of the Senate or House Committee?

Mr. Kobrick. It was, your Honor. That document was before them, and I think the record will show it. I am not sure the reports make any explicit reference to the release.

The Court. It was thought to be important in the Hirabayashi case. Whether it should be so regarded, I do not know.

Mr. Kobrick. All the references are set forth at some length in our brief. Now, there is one final contention, as to retroactivity, which is part of the contention as to the meaning of the statute.

The Court. Well now, supposing that on its face a determination referred to a recapture of excessive profits in 1940. Would I have to enforce without further inquiry such a determination?

Mr. Kobrick. Your Honor, I think the fact is that the statute—you would then have the constitutional problem of retroactivity—but the statute in terms authorized recapture of that type of profit in proper circumstances.

The Court. In 1940?

Mr. Kobrick. The exact provision is this: that all contracts and subcontracts, whether made before or after the statute, are within its provisions if final payment had not been made by the date of the statute. On a sharp construction of the contract, payment might be open up to April 28, 1942.

The Court. I am not quite clear. Are all the payments in this case conceded to have been made after the enactment of the statute?

Mr. Kobrick. After April 28, 1942. That is my understanding.

The Court: Is that correct, Mr. Park?

Mr. Park. That is correct.

The Court. But they say that some of the payments were earned under contracts which antedated the statute.

Mr. Kobrick. As I understand it, that is not the contention. The contention is this: When the statute was passed, it provided for re-negotiation of profits earned in contracts with various departments, provided that payment had not been made by April 28, 1942. No definition was written into the statute at that time of the word "sub-contract". In October, 1942, Congress adopted a rather detailed definition. Most of the debate between Mr. Park and myself has revolved about the meaning of that definition. The defendant asserts that even if we are right that the sub-contract detailed definition is sufficient to cover this business, it could not have been covered by the original statute carrying only the undefined term. While the October amendment is expressly made retroactive, and therefore anything for the period between April and October is covered by a retroactive statute, and is therefore unconstitutional.

The Court. You make two arguments: that it is covered in the original statute; and if not covered under the language of the original statute, it may be covered retroactively?

Mr. Kobrick. We make both. The question of retroactivity is a common one in those cases. Certainly, in some cases the contracts, where large items are being manufactured, would reach back of April 28, 1942, and the full year would be subject to a re-negotiation order. The first proposition, that the term "sub-contract" could fairly be read to apply to this business, is predicated on the proposition that the obvious purpose of this statute was to control excessive profits on war business, and the legislative history makes that abundantly plain. The statute was passed at a time when Congress was pressed with a multitude of very grave problems, and the failure to produce a polished, elaborate piece of legislation is rightly understood against the background of 1942. I think that proposition is fortified by a decision in the United States Supreme Court, which says that "sub-contract"



has no special meaning. Also there is in substance a Congressional construction of the statute by the October amendment. As we read that legislative history, it was never supposed that the original statute was narrower than the definition made it.

The Court. Let me look at the first statute, before it was amended. Could the secretary of war recapture from a worker in the Bethlehem Shipyard an excessive amount paid to him as wages?

Mr. Kobrick. He would have to make a minimum of \$100,000 a year.

The Court. Let's assume he was an officer at that time.

Mr. Kobrick. There was a special exception with respect to full-time employees. Those were reached in a different way.

The Court. Let's suppose it was Cravath, deGersdorff, Swaine & Wood who charged for legal services what was deemed by the secretary of war to be an excessive amount. Could it be recaptured?

Mr. Kobrick. That has never been tried. Engineering services have been subject to renegotiation.

The Court. So it is your view that I should read the word "sub-contract" as it appears in the original statute as meaning any item of expense which a contractor has which involves payment of over \$100,000, regardless of whether the relationship is a relationship technically of sub-contractor or not, provided it is an expense that enters in?

Mr. Kobrick. I think it is not necessary to read the statute as broadly as that for the purposes of this case. It is sufficient to say that every stage in the processing of a product ultimately used in the war effort, and payments for services or goods which are incorporated in the product in final contracts are included.

The Court. How about insurance? Can you recapture from an insurance company an excessive amount of a premium?

Mr. Kobrick. Again I have never heard of an administrative determination with respect to insurance.

The Court. I am trying to test what the language means. In your view is it limited to processing materials?

Mr. Kobrick. I think it would have to be more directly related.

The Court. That is pretty directly related, insurance on the goods while they are being handled.

Mr. Kobrick. I suppose the particular example of insurance probably affords its own controls, and might not have raised any problem. There is another provision of the statute that may bear on this, and that is the power of the administrative department to disallow excessive or unreasonable costs or salaries, and through that medium it might be argued that that type of thing was contemplated. That would not reach a bona fide payment to a processor who was charging the market rate or OPA maximum price at the time.

The Court. You want me to read the word "sub-contractor" in the original statute in the same way as the Supreme Court read "employee" in the National Labor Relations Act, to apply to somebody who was not really an employee but was deserving of coverage?

Mr. Kobrick. It seems to me that the philosophy of that decision is precisely applicable here; that is, that Congress intended a certain result here and used language that, while not the happiest choice for that result, at least is susceptible of accomplishing the result. Certainly, while you have much more here, certainly if the lower court had made such a decision as in the Hirsch case, there might have been some questions as to whether they correctly understood Congress. But there can be no such question here. At the earliest practical date at which there could be such an enactment, we have a clarification of that expression. I might say, your Honor, there is something of an anomaly in a consideration of this problem in the light of the Waterman decision, an anomaly which I suppose is unavoidable because in this aspect of it the question of coverage becomes also integrated into a question of constitutionality. I suggest this: that if there be any substantial constitutional doubt about retroactivity of the October amendment, it should be fairly resolved by interpretation of the original statute to reach this business. I would like to say also that I think we can sustain the legislation even though it be retroactive.

The Court. How far back can retroactive legislation go? Could Congress recapture under contracts of World War I?

Mr. Kobrick. I think that would offend the Constitution, as being outrageous. There was a case a good way back, *Calhoun v. Massie*. The contract was entered into between a lawyer and a client for a percentage of any amount collected by the attorney in prosecuting a Civil War damage case. After a good many years of effort ultimately some recovery was accomplished. In the meantime Congress had passed a statute limiting the percentage of compensation to a much smaller figure than the amount specified in the contract. The case was at least ten or fifteen years after the date of the statute. In the Supreme Court Mr. Justice Brandeis concluded that there was nothing unfair about that, because it was the kind of thing which Calhoun could fairly expect would be regulated, in the light of past history. Essentially a question of retroactivity becomes one of fair dealing, and some basis of action must be adopted. Certainly where there is a past history—and certainly in an excessive profits question, there is a long past history—some degree of retroactivity is permissible. Now, the maximum in this case would be six months.

The Court. Does it make any difference that the period falls within a single calendar year?

Mr. Kobrick. Certainly the tax cases in almost every year reach back and cover income received in the earlier months of that year.

[Short recess.]

Mr. Kobrick. I may have been a little too long-winded this morning. I think I can conclude in a very few minutes. The question of how much retroactivity is too much is one which I would not want to try to answer categorically. In the tax field there is one case in which a Wisconsin statute, which reached back two years to tax income realized two years before the statute was passed, was held valid.

The Court. If you take the line of the tax cases, you come within the period of time that has been upheld?

Mr. Kobrick. Well within it. I think I can repeat here what I

said earlier. Rightly or wrongly, it is our view that this was an exercise of the war power, was intended as such, and must be valid where it goes no farther with respect to retroactivity than the tax power.

The Court. Could a price be fixed in connection with a commodity for a period six months preceding the date on which it was fixed, even though the price regulation was a war time regulation? Well, never mind. I think there are cases closer than the tax case to the question we have here.

Mr. Kobrick. I think the case you put here would raise some very serious hardship problems. There is also some suggestion that there is an interference with contract rights.

The Court. An exercise of Congressional power is a valid exercise—I thought that had been decided by the Gold cases.

Mr. Kobrick. That was the only remaining question I had to discuss at this point. I would like to reserve ten or fifteen minutes for rebuttal, if I may. Before I sit down, I have one recent decision in the District Court which your Honor may be interested in looking at. It came down the 22nd of March. It adds very little to a case that we have already sent to you. This latter case is decided chiefly on the authority of the earlier one. There is a decision that the renegotiation under those circumstances is valid.

Mr. Park. If your Honor please, having listened to the arguments and to your Honor's questions, the feeling which I had before I came down here has been confirmed, that is, the feeling how inadequately I have briefed the case and how inadequately I have argued it. The argument which I expect to make to your Honor today will perhaps be made slowly, painfully, but it will be given you for what help it can furnish the court. As I have sat here and listened, it seemed to me that the first point I ought to discuss is one on which I think we would be rather inclined to agree, but it is the touchstone to the other arguments, and that is the question: What is the nature of this liability? This is a suit on a unilateral determination under the Renegotiation Act for a sum of money,—a liability supposed to have been created under that unilateral determination. What is the nature of that



liability? I think, and I think your Honor has indicated, that it is a sanction of some sort to enforce a regulatory act. Clearly in this case it is not contractual. Some cases might arise under the Renegotiation Act where it was contractual. There is a faint suggestion in the brief of the United States that there is some element of contract involved here; but I won't even argue it. I think there is nothing in that. It is perhaps disposed of by the case of *Spaulding v. Douglas Aircraft Corporation*, where they held there was no estoppel on a subcontractor. The subcontractor much more clearly than in this case indicated some consent to the Act.

The Court. I understand that the Government used this as an instance of its regulatory power.

Mr. Park. Nor is there any contention that it is under the taxing power. It is said that it is an exercise of the power to wage and to wage war successfully; and it is said, in order to wage war Congress may enact laws to prevent profiteering. We agree with that, with this proviso, that the exercise of the power to wage war, like the exercise of any other power, is subject to constitutional limitations. A government constituted under a written constitution cannot throw that away when it wants to wage war, even to wage war successfully. Therefore, the question is not whether it is an exercise of the war power. It is intended to be, and I haven't any doubt it was intended to prevent profiteering. The issue is whether that has been done within constitutional limitations.

The Court. I think you both agree, for instance, that if the statute says, "Congress directs that any profits in excess of 6 per cent shall be recaptured by the Government", there would be no question that Congress had the power to direct that?

Mr. Park. I think so.

The Court. You really quarrel with the method which has been followed in authorizing the departments, including the War Department, to determine without what you refer to as adequate standards, what are excessive profits; and you quarrel also with the provision which has been made for any determination by the secretary of war.

Mr. Park. I make both those objections. I think the case goes

even further than that. I say that this liability—call it sanction or penalty—it is in the nature of a penalty—it is a liability that is created after a certain course of conduct which Congress intended to prevent or regulate, and it is a liability to pay money by reason of something that the defendant has done which Congress says it ought not to have done.

The Court. I am not quite clear. Are you saying, all these determinations are invalid on that ground, or only so much of the determinations as covered payments made in 1942?

Mr. Park. On that ground I don't say—it is perfectly proper, I think, for Congress to impose sanctions on profiteering, to impose liabilities—I don't question the power of Congress to say, "You have done something which you should not have done, and therefore you become liable to a penalty", provided again the Act of Congress is within these constitutional limitations, and providing it does not delegate legislative power without setting up adequate standards, or provided it does not attempt to impose sanctions or penalties, because a man has not done something which Congress may not say he shall do. That is the second point with which I dealt in my supplemental memorandum. I say the nature of the liability will determine a lot of these questions. Your Honor spoke about the question of retroactivity. If this is a penalty, Congress cannot impose penalties or sanctions if that is a milder word, for something that somebody did before the law was passed. I don't think Congress could in 1942 say, "We will impose penalties on everybody who profiteered in 1941." Nor do I think it could say in October, 1942, "We will impose penalties on people who profiteered during the fiscal year ending June 30, 1942."

The Court. I don't suppose you contend the Ex Post Facto clause, Article I of the United States Constitution, is involved in this case? You merely say that this is a retroactive law under the Due Process clause, the Fifth Amendment?

Mr. Park. That is right. I do not say it is an ex post facto law. I think it is retroactive. If it attempts to impose sanctions or penalties for acts before the passage of the law, it is invalid

under the Fifth Amendment. There seems to be no dispute between us either as to the question as to whether this is an exercise of the legislative power, that is, the power to impose such sanctions. At common law there is no sanction against profiteering, and the United States has no right to recapture or recover allowances merely because they think they were too large. That is settled by the Bethlehem Steel case. I use the word "recapture". I think that is a little loose in this case. This money that the defendant received, it received from persons other than the United States. The United States may never have paid anything on account of this. There is no evidence, and the affidavit shows that it was never considered, as to whether or not the United States paid any money.

The Court. That raises a question that somewhat bothers me, Mr. Park. Supposing that the United States entered into a contract with Bethlehem Steel to buy a ship for, shall we say, a million dollars, and Bethlehem Steel contracted to buy steel for the ship for \$100,000 from the United States Steel Corporation, and Bethlehem paid the \$100,000 and bought the steel, and for some reason the United States rejected the ship when Bethlehem offered it to the United States, so that the contract between the United States and Bethlehem was frustrated, and no payment passed at all from the United States to Bethlehem. Under those circumstances do you consider this statute as purporting to go so far, as to authorize the United States to recover excessive payments made by Bethlehem Steel Corporation to the United States Steel Corporation?

Mr. Park. Well, I should not. I should not because I think the statute imposing liability in the nature of a penalty, ought to be construed rather strictly. It ought not to be construed to include contracts which might have been subcontracts if the prime contract had been performed. But I don't know what position the Government takes on that.

The Court. Is there anything in these determinations which are annexed as exhibits to the complaint to show whether the

United States ever paid any sums of money to the persons for whom Alexander Wool Combing Company did combing?

Mr. Park. No, sir; there is nothing in the determination.

The Court. And you say that therefore on its face the determination falls short of making out the allegations necessary to warrant recovery?

Mr. Park. Well, I would say that; but I think it is a fair inference from all the statute and the procedure that the secretary would make some finding somewhere along the line that the United States paid something to somebody, who paid something to somebody, who paid something to somebody, who paid something to this defendant.

The Court. Where does that appear?

Mr. Park. It does not appear in the determination.

The Court. Does it appear in the complaint?

Mr. Park. I don't think so. Of course, we admitted on evidence and affidavits, that we did work for Nichols & Company, who was a top maker, who sold to people who presumably put some tops into cloth and sold it to the Government. But there is nothing to show that even if something were paid, Nichols & Company, for instance, did not take a loss on selling top, or the man who sold the cloth did not take a loss on selling top. So that there is nothing to show, not only in the unilateral determination, but in any procedure involved, that the Government ever lost any money or ever had to pay more money than it should, by reason of any profits made by this defendant. That sort of question was never investigated. There was no inquiry made in the proceedings as to whether or not the Government really, ultimately, as a result of Alexander Wool Combing's charge, paid too much for anything. In fact it may have paid less than the fair value of the cloth. Anywhere along the line the other contractors apart from Alexander Wool Combing Company may have lost money and absorbed any excess profits, if there were any, of Alexander's. There is nothing called for in the nature of the proceedings, for any inquiry into that point at all. So when we talk about recapture, there is nothing to show there was anything in the nature of



recapture. The most that can be shown is that this is a penalty imposed upon Alexander Wool Combing Company because in war time it made profits which some of the people sitting in Washington, who knew nothing about this business, felt were excessive,—such as the under secretary of war, whom the representative of Alexander Wool Combing Company never met. We never met before anybody who had any power to decide anything. We were before people who could listen and ask questions and make recommendations and proposals, which, if we agreed to them, would be put in effect. If we did not, we were left in suspense.

The Court. As you made your statement, you halted after you said "we were left". Couldn't you have gone on to say, "We were left to our remedy in The Tax Court"?

Mr. Park. Yes; we had that. I don't need to repeat the rule that legislative power cannot be delegated, that there must be standards. Your Honor said there were only two decisions of the Supreme Court that so hold.

The Court. No, no; no. There are only two decisions in which that rule has been applied in a way to invalidate the actions of the executive departments. Isn't that correct?

Mr. Park. When your Honor spoke of those two cases, I couldn't think of any offhand. There are, of course, many decisions of the lower courts that have held acts of executives unconstitutional because of lack of standards. I say that proposition could hardly be disputed. It was not disputed this morning. In the brief there is this very interesting statement:

"The essence of legislative power is the enactment of general rules having general application."

Of course that is not so.

The Court. I promise not to use that phrase in my opinion.

Mr. Park.

"The Act does not contemplate that the renegotiating officials shall formulate such general rules."

I think that is true.

"What the Act contemplates is, on the contrary, a case by case consideration of the circumstances of each individual contractor and a judgment in each case as to whether the profits realized are excessive."

I think that is true. And I think that is just why the Act is a delegation of legislative power.

The Court. May I interrupt by putting to you the two cases I put to Mr. Kobrick? How do you distinguish this case, first, from the statutes which give to a public utility commission power to fix reasonable rates? And second, how do you distinguish this case from the Emergency Price Control Act of 1942, which, after a deluge of language, allows the Administrator to fix prices for all kinds of commodities?

Mr. Park. Well, on the first point, the public utility illustration, I distinguish it in this way; that reasonable rates for public utilities have a meaning which has come down to us from at least two hundred or three hundred years of common law decisions *re* docks, warehouses, railroads, public conveyances. They have been required to fix their rates, and the words "reasonable rates" had acquired a meaning, that the rate was something, a fair return upon the investment.

The Court. The sort of thing that would enable you to predict to your client exactly what the Commission would decide.

Mr. Park. Yes, sir; you had some idea.

The Court. You have been very fortunate.

Mr. Park. You have no idea at all when you are talking about "excessive profits". In the first place, the word "profits" is not such an easy thing to define. It is not the same thing as gross income, or net income for purposes of the Internal Revenue Code. Those are statutory concepts that vary almost every time Congress passes a revenue act. "Profits" are not gross income, and they are not net income under the Internal Revenue Code. They are something else. Some accountants, for instance, think that the Internal Revenue Code imposes very bad kind of practices upon certain companies at least, because they are required to keep

their accounts and compute their income in a statutory way which does not adequately and properly reflect their profits. If I may be excused for reading something to your Honor, there are lots of books on what profits are. One is Epstein on Industrial Profits in the United States. I would like to read a passage, pages 4 and 5:

"Business profits are one of the hardest kinds of income to measure. Any business enterprise should be able to state accurately the sums that it has paid out in the course of a year as wages, interest and rents; it should be able to state also what income it has paid out to its owners. But the profits of the enterprise itself are not definite sums fixed by past transactions. On the contrary, they are appraisals of net changes in the position and prospects of the business as a whole—appraisals that look forward to the uncertain future as well as back to the irrevocable past. Like all mixtures of past history and future anticipations, statements of profits are unnecessarily subject to variable margins of uncertainty.

"Besides ascertaining the difference between actual receipts for whatever the business has sold and actual payments for whatever commodities and services the business has bought, the accountant who is estimating income must put values upon all the property belonging to the business. What will the raw materials, goods in process and finished products realize when sold? What part of the accounts receivable will prove uncollectible? What will the holdings of shares in other business enterprises be worth? If the enterprise owns franchises, patents or other income-bearing rights, what allowances should be made for their approaching termination? At what rate is the physical plant depreciating? Is it becoming obsolete faster than it is wearing out? Are there wasting assets for which a depletion charge should be made? Has the business other properties, such as lands or long-term contracts, that are growing more valuable or less valuable? What part of the profits flows from current operations such as will probably be continued and what part from

'capital gains and losses', such as the sales of securities owned by an enterprise, or the redemption of its own obligations at less than face value? Is the profits estimate to be made on the assumption that the enterprise will continue in business, or on the assumption that it will liquidate its affairs?"

Now, I say profits are hard enough to determine; and then you come to the question of what are "excessive profits"? Well, it has always been the theory, I think, of our law that in normal, fair and free competition there are no excessive profits. The man who could bring into the market something at a much lower cost than his competitors could, was entitled to it. That was merit which ought to be rewarded. Nobody thought of suggesting that Henry Ford made excessive profits because he had been able to put a car on the market that everybody could buy. In peace-time, normal, fair competition there is no such thing as excessive profits, there is no such concept. The larger the profits the man can make, the greater the reward to which he is entitled. That is the theory of private capitalism, that you are entitled to a reward commensurate with your effort.

Of course there may be other situations, where a fair competition is interrupted by monopolies, restraints of trade, and so on, when we may say, "No, this man's prices are not fair and reasonable market prices. They are the results of monopoly, or they are the results of some other unlawful and wicked advantage." And we all have some conception of what the word "profiteering" means. And I agree that there may be profiteering in times of war. We do not deny that.

But when does a man profiteer? When he insists on just compensation for what he sells? When he says, "No, sir. I want the fair market value", and there is a fair market value, there is a market at ceiling prices fixed by the Government or below ceilings? Is that man a profiteer when he says, "You cannot take this from me without giving me the fair market value. If you want to requisition it, the Fifth Amendment protects me. I won't sell it for that"? Can Congress say, "If you insist on fair market value, then if we find you have made a profit which in the opinion



of a secretary or some well-informed man is deemed to be excessive, then we impose a penalty on you as a profiteer, because you insist upon the just compensation to which you are entitled under the Fifth Amendment"? \*

But whether I am right on that or not, Congress did not define the words "profiteering", or "excessive profits". They left that to be determined by the secretaries, three of them at first, and then four of them. That each one might determine in his own opinion. They were not bound to consult. They might disagree. One of the secretaries might have adopted the view which I have suggested, that a man who got only fair market values was entitled to any profit he could make. Another secretary, the secretary of war, might have adopted that other view. Congress did not lay down any rule. They left it for these four secretaries to make up their minds, not only what are profits, but what are excessive profits, all the questions involved, although the Act was applicable not only to corporations whose profits might be computed in one way, but to partners, and to individuals. Now, a partner's services, his contribution he takes out in the form of profits, may not be paid for at that time. His individual services, is there any allowance to be made for that?

The Court. I am not trying to support the language of Congress, but don't you think it might be said on behalf of the phrase "excessive profits", that any attempt to give an iron-clad definition drawn with very specific phrases would operate more unjustly, in view of the grave difficulty in determining what profits are, as shown by the quotations which you read?

Mr. Park. Your Honor, to answer that, I will come right down to the nub of the argument; and that is this: There are two conflicting principles of government. One of them is that one you see carved on the marble palace where the Supreme Court sits: "A government of laws, not of men."

The Court. As I remember it, it says: "Equal justice under law." Are you talking about the Supreme Court of the United States? \*

Mr. Park. Yes, sir.

The Court. The phrase says: "Equal justice under law."

Mr. Park. Let's assume I am wrong as to where it is carved, but the phrase is still familiar to us.

The Court. Yes; it comes from John Adams. It is in the Declarations of Rights and Constitution of Massachusetts, but it is not in the Constitution of the United States.

Mr. Park. Nevertheless, it is a principle. And there is another principle: "The informed judgment of a good man."

The Court. Oh, well, we do not operate on that basis.

Mr. Park. No, we do not; but I say that there are those two theories of government. We want rules, not the judgment of the good man. But, sometimes you get problems, like this one, where it is much the easier way, and it might even seem to be the best way to some people, to substitute the judgment of a good man. And if your Honor please, I think that is just what this Act did and was intended to do. It is the whole theory of the Act, that we cannot make rules, it is too complex; so here is a case where we won't make rules, won't lay down standards, we will say, "Let these Secretaries, who are fine men, decide when in their opinion excessive profits have been realized."

The Court. Would it be fair to say that the dilemma shown by your quotation comes down to this: There were these choices open to Congress: first, to have no regulation of profits; second, to have regulation in which a very wide and almost uncanalized discretion was given to individuals; and third, to have a set of detailed rules which would act as a procrustean bed, most fairly in these specific cases which could not be foreseen? Were those the three things open to Congress?

Mr. Park. You mean constitutionally?

The Court. I am not saying constitutionally.

Mr. Park. I think the second option—that is the one on which I would want a little further definition, as to whether they say, "We give them broad standards, and some discretion, discretion as to how to apply them", or whether you mean, "We will give them no standards but pure discretion."

The Court. I merely say, they might have spelled out certain

criteria in greater detail. I suspect if they did that, you would have something like the Emergency Price Control Act, which gives you ten or eleven different standards, which would give you just as much control as if they had not written them out.

Mr. Park. When they amended in 1943, they did try to give some criteria, and rejected the definition of October, 1942, under which this unilateral determination was made. In October, 1942, they said:

"The term 'excessive profits' means any amount of a contract or subcontract price which is found as a result of renegotiation to represent excessive profits."

"Is found." That means, I think, that they just said, "That is a question of fact for you gentlemen. There is no law about it." That is what Mr. Kobrick says. You consider it case by case. There is something I am going to read your Honor a little later where they talk about how this is fitting the law to the facts.

The Court. Couldn't Congress have used the language: "The Secretary shall determine what the services are worth and what the goods are worth on the basis of quantum meruit and quantum valebat"? Then they would be common law standards.

Mr. Park. Yes. Then we would be entitled to fair market prices. Then we would have said, "Mr. Secretary, we are entitled to those rates. We made no excessive profits." No. They did not do that. At least, I don't know whether Congress thought that out. At least they turned it over to the secretaries to decide, each one as they chose, and after them, The Tax Court, which may create some other standards for all I know. They are not bound by any standards which the secretary of war may apply, or they may decide there are no standards. We don't know. There have been no decisions yet by The Tax Court on any of these petitions for renegotiation.

The Court. The Government, which has more knowledge than anybody about this, agrees with you. Isn't that true?

Mr. Kobrick. As of about a month ago, that is correct. I might add that the cases in The Tax Court, a number of them, have been tried in the last few weeks. So we expect some decisions.

Mr. Park. I have been looking for some opinions also, and haven't seen any. I say the choice of that word "found" certainly leaves it open to the secretaries. And I say, it was intended. Now, your Honor, I submitted to you this pamphlet of law debates and other legislative materials. I set out some of the excerpts from that in my brief. It is perfectly clear that the people who were introducing the bills in Congress thought there was no yardstick or standard. I won't quote this now, because I want to call your Honor's attention a little later to some other Congressional material to the same point. I think if you read this collection through, you will find no evidence anywhere that anybody thought there were any standards, and abundant evidence that Congress at least thought itself, when they passed this Act of October, 1942, that there were no standards, that they were leaving it wholly to the consciences of the secretaries; and that many members of Congress thought they had exceeded their constitutional powers, and some of those who voted for the Act voted for it because it was part of an appropriation act which was needed to expedite the war; and there was some complaint and bitterness that this particular thing should have been put in the Act.

The Court. You do not seem to distinguish in your brief between the standards appropriate in time of war and standards appropriate in time of peace. I take it you think that the standards are the same?

Mr. Park. Oh, I would not make as broad a statement as that. There may well be cases. The Hirabayashi case is one. But, after all, here was a law which was administered at least a year after the contracts are completed. When fiscal years are closed you come in, and months later you are renegotiating about it. There was no such reason for hurry that you could not set down and set up proper standards, if you are going to make the law retroactive anyway. It is not like some act where an executive is called upon to act, looking prospectively, as a military commander is. This is a review, after a year is over, of business done by contractors. I say, in that situation I see no reason for distinguish-



ing between war-time legislation and peace-time legislation, except on the theory that war-time legislation is drafted so hastily that you can let it be a little worse. I do not think that that is sound theory.

The Court. No; but it seems to me that the measure of discretion and choice given to administrative authorities may be larger in times of war than in peace times. When subordinates of the secretary of war decide whether your sons shall fight in the Battle of the Bulge or sit in the Pentagon Building, it is not so surprising that they shall decide whether you are making excessive profits or not. It is all in the temper of what the secretary of war thinks is necessary.

Mr. Park. It is all in the temper of war-time, which is sometimes hasty and ill-considered, which is apt to wave the flag and talk about sending our boys to war, and say, "Why should we concern ourselves with property rights?" We all feel that way. I don't think the Constitution says that. It might have said, "In war time Constitutional limitations shall be suspended." It did not say that. It might have said, "In war time we will elect a Commander-in-Chief and he will make the rules and regulations as he chooses." That is more or less a part of early Anglo-Saxon law. We never adopted that in this country. I think in this connection too, the Cohen Grocery case and that other line of cases that held that "excessive prices" was too vague a term for the courts to administer, ought to be considered. The Supreme Court said the words were too vague in a civil case as well as penal cases.

The Court. But did not say too vague to be standards for administrative action.

Mr. Park. No; because the statute did not call for administrative action, but nevertheless said it was delegating legislative power to the judiciary. Perhaps there is some difference between the amount of legislative power you can delegate to the judiciary and what you can delegate to administrative action.

The Court. Although I take the stand that each judge must determine for himself the question of constitutional law, I don't

suppose any judge can be unmindful that the same question has been presented to a number of judges and a decent respect for the views of other men leads him to pay some attention to the judgment of other judges. This question you are now arguing has been before a number of different courts, has it not?

Mr. Park. I understand that *Spaulding v. Douglas Aircraft*, decided by the Circuit Court of Appeals for the Ninth Circuit, decided the precise question I have just been arguing in my favor. Let me get the opinion. The court was dealing with the question of standards, and it pointed out that this pamphlet, "Principles, Policies and Procedure to be Followed in Renegotiation", issued by the War Department, had been submitted—a copy of it submitted to a sub-committee of the Senate Finance Committee; and then it said, "Since the directive was before the Congress in the consideration of the amendment to the Renegotiation Act, its passage on October 21, 1942, gives to the standards of the War Department's directives the same validity as was given to the President's curfew regulations of March 2 and 16, 1942, in *Hirabayashi v. United States*." Then skipping a little bit:

"The parallel between this case and the *Hirabayashi* case is precise. Here as there a contention is made of delegation of legislative war-making powers. Here as there, action was taken by executive officers of the Government which was said to be without proper Congressional direction. Here as there, this executive action was brought to the attention of Congress, and Congress thereafter passed a statute which constituted approval of the executive action. And accordingly, here as there no question of delegation of legislative authority remains open. Whatever difficulties may be found in the original Act, the amendments of October 21, 1942, merged the detailed administrative practice with the statute in a manner to foreclose all possibility of further doubt."

Now, it was not necessary to decide that the administrative practice had been merged with the statute if the statute was sufficient by itself. There is no statement in the opinion that the standard set up by the statute was sufficient. I think I am coming to this suggestion by the court in a few moments, because I think that

certainly cannot stand,—this suggestion that this was on all fours with the Hirabayashi case. It is on that point that I want to read your Honor something from the reports of Congress. It is perfectly clear that Congress did not think so. I will come to that. This opinion implicitly realizes that the statute itself sets up no standards. It avoids making any answer on the point. This answer they give is not in the alternative. They don't even say, "Even if". In the Hirabayashi case, of course, the statute passed refers in terms to an executive order and to proclamations made by the military commander. It incorporates them by reference. All it had to do was to put in the numbers and it would have been a completed incorporation by reference.

The Court. If you should at the moment walk across the hall into the Circuit Court, you would hear an argument on that statute, in which you would hear that that statute to which you have referred incorporated by reference a number of regulations other than those before the seats of Congress. So I think your construction of that statute as incorporating by reference only certain specific regulations issued by General DeWitt is not correct.

Mr. Park. That is a question I do not have to answer. I do not have to say "only". I say it did incorporate those by reference. So in the Hirabayashi case, where you were dealing with an executive order and military proclamation expressly incorporated by reference, you did not reach this other question at all. And certainly this case is distinguishable on that ground. Now, if your Honor please, if Congress did know about this directive and pamphlet "Principles and Policies", issued by the War Department, it must also have known that the War Department was not the only agency that was administering this Act, and it should have known that the Navy Department and the War Department did not agree upon the principles to be followed. The Truman Committee report, which was issued at some time later—if I may read briefly from the Truman Committee report:

"The History of the First Ten Months of Renegotiation.

As might reasonably be expected in the case of any new

procedure, the first ten months of operation under the law which became effective April 28, 1942, have revealed many imperfections. Some have already been corrected. Others are in process of correction. Still others call for prompt corrective measures not yet undertaken. These conclusions become apparent from a recital of the history of the first ten months.

The law itself vests responsibility for renegotiation in four different department heads, the Secretaries of War, Navy, Treasury and the Chairman of the Maritime Commission. It is obvious that with their manifold war time responsibilities those officials could not personally consider the price adjustments of 85,000 or more separate contractors estimated to be subject to the provisions of the law. Responsibility had to be delegated and was delegated; but it was delegated not to one board, but to four. The result was four independent groups, set up with entirely different types of organization; sometimes applying different basic principles in determining allowable costs, allocations of renegotiable and non-renegotiable business, and amounts of profits deemed excessive. Moreover, each group is subject to the influence of different individual philosophies of the chairman of the respective boards as to the job to be done, with members of one organization frequently functioning in ignorance of policies applied and results reached by members of other organizations dealing with similar situations."

What evidence is there that Congress picked out the War Department's principles instead of the Navy Department's principles? The fact is, they knew there were four sets of principles, four philosophies, and they left it, they left it just that way, to be found by each secretary or each person to whom he delegated as he chose. Now, it is ridiculous—I don't like to use that word "ridiculous"—

The Court. Well, you don't agree with the Circuit Court of Appeals?

Mr. Park. Yes. I don't. On October 7, 1943, there was com-



mitted to the committee of the Whole House on the state of the Union and ordered to be printed a report of the committee on Naval Affairs, House of Representatives, pursuant to House Resolution 30, dealing with renegotiation of war contracts. That is House Report 733, 78th Congress, 1st Session. And under Title VII, "Principles Applied by the Departments in Renegotiation", we find the following. This report, by the way, and the recommendations in it were the basis of the amendments which were made in the Revenue Act of 1943.

"Lack of standards for the determination of excessive profits in the law.

The law as first enacted embraced contracts awarded by the War and Navy Departments and the Maritime Commission. No provision was made in the law itself for the co-ordination of the activities of these three agencies in the administration of the law. The heads of these agencies might well have evolved different standards and different rules for the conduct of renegotiation. It is to their credit that from the first they realized the importance of developing a uniformity of approach, and evolved a set of joint principles and policies so that the question of whether a particular profit was excessive was not influenced by the fact that one particular agency, rather than another, made the determination.

The heart of the law rests in those provisions which authorize and direct the heads of the Departments to renegotiate contracts and eliminate any excessive profits wherever it appears that such excessive profits have been or are likely to be realized. The law had been enacted by Congress to meet a rising public disturbance at the discovery that excessive profits were already being made. The public, the press, and Congress were all insistent that excessive profits be outlawed on war contracts. It is precisely that which the Act did. Section 403 (a) (3) defined excessive profits as "any amount of a contract or sub-contract price which is found as a result of renegotiation to represent excessive profits". In effect, excessive profits were defined to be excessive profits. Obvi-

ously the broadest latitude ~~was~~ allowed to the department heads in determining whether a particular profit was excessive.

It is from the vesting of this discretion in the Departments that much of the strongest criticism of renegotiation has arisen. It has been said that since no standards were written into the law which the renegotiators must follow, they are confined only by the limits of their own judgment, and that hence the powers which they exercise over industry are not those of law but of men. The suggestion has come from many sources that the law be amended so as to state specifically the factors which the renegotiators shall consider in reaching their decisions. With this we are in agreement. We think that a study of the experience of the Boards thus far should provide an adequate basis for determining what these standards should be, and that the law should be amended so as to specify the broad general standards to which the Boards must conform in making their determinations."

The Court. Which is the Act that followed upon that report?

Mr. Park. If you have this volume, "The Renegotiation Act", it starts at page 18, the Revenue Act of 1943. It was not enacted until February 25, 1944.

The Court. You say the several factors set forth there are adequate standards?

Mr. Park. Do I? No, sir. Now, skipping a bit, starting at the bottom of page 35—

The Court. How much longer do you want? It is one o'clock.

Mr. Park. I think perhaps an hour.

[Adjourned at 1 P.M., to be resumed at 2 P.M.]

#### AFTERNOON SESSION.

Mr. Park. I was reading from a House Report, No. 733, a report by the committee on Naval Affairs on renegotiation of war contracts, and at the bottom of page 35 I will continue the reading:

"During the course of the committee's study, we were constantly on the alert for a formula which might have been employed by the renegotiators. The representatives of industry whose companies had been renegotiated were ignorant of any formula which had been used in accomplishing the result of their renegotiation. The members of the Price Adjustment Boards were, with the exception of the representative of the Maritime Commission Board, emphatic in denying the existence of any formula."

And then skipping a paragraph:

"The complaint of industry on this score seems to be that they are unable to determine in advance exactly how much will be left ~~then~~ after renegotiation. They desire some exact formula, which they can then apply to their own situation, and which will indicate to them just how much they will have left. Such exactitude would have been known to them under the Vinson profit-limitation bill, which they opposed. We are satisfied that no such formula exists. There are, however, a series of factors which the Boards consider in determining the margin of profit to which a contractor is entitled. The Boards examine the contractor's operations to determine how they compare with those of other contractors in respect of factors such as price reductions and comparative prices, efficiency in reducing costs, economy in the use of raw materials, efficiency in the use of facilities, and in the conservation of manpower, character and extent of subcontracting, quality of production, complexity of manufacturing technique, rate of delivery and turn-over, inventive and developmental contribution with respect to important war products, cooperation with the Government and with other contractors in developing and supplying technical assistance to competitive peacetime business, the amount of private capital invested in the contractor's business, the financial assistance which the contractor has received from the Government, and the contractor's peacetime earnings.

Consideration is also given to possible increases in cost of materials, imminent wage increases, and the risks assumed by a contractor, such as inexperience in new types of production, delays from inability to obtain materials, rejections, spoilage, 'cutbacks' in quantities, and guarantees of quality and performance of the product. The Boards also state that they recognize that a contractor whose pricing policy results in comparatively reasonable profits is entitled to more favorable treatment than a contractor whose pricing policy results in a large amount of unreasonable profits, unless this is attributable to reducing costs rather than overpricing. They point out that the contractor who maintains only a reasonable margin of profit is subjected to the risks incident to the performance of a fixed-price contract, while the contractor who practices overpricing usually has taken a few, if any such risks. The Boards stated, and the testimony before the committee confirmed the fact, that the contractor in every instance is given ample opportunity to develop and present information with respect to all of the above factors and any others which may be relevant to the over-all policy of performance, upon which his profit reward is based.

The net effect of this may be summarized rather simply. As renegotiation is now practised, there is no set formula for determining a profit in the sense that in every case a set number of factors are taken into consideration and each factor carries in every case the same relative value. Instead, the Boards have stated that the factors above enumerated—which are made known to the contractor by furnishing each of them with a copy of the Joint Statement of Purposes, Principles, Policies, and Interpretations—are always considered, but that the value of each varies from case to case. Thus, if there are two contractors who have produced the same article equally well, but one has produced it in a plant which he has built with his own funds and at his own risk, and the other has produced the article in a Government-built-and-financed plant, a larger margin of profit will prop-



erly be allowed to the contractor who has assumed the greater risks.

If one manufacturer has developed a particular article, and, in order to obtain a greater volume of production, other manufacturers are also given contracts to produce it, the manufacturer who has spent funds and years in developing the product should and will receive a greater margin of profit than the other contractors. If two manufacturers both produce the same article in the same quality, but one produces at a substantial saving of time over his fellow, the speedier one may also be allowed a higher profit.

A criticism made time and time again of the manner in which the Price Adjustments Boards have applied renegotiation is that they make no allowance for efficient and low-cost production, that they provide no profit incentive for a contractor to do the best possible job at the lowest possible cost. At the outset it should be said that in a Utopian society such incentives would be unnecessary, that patriotism alone would be sufficient to impel every man to do his best, and that no citizen would desire to emerge from the war with more than he had when the war began."

Then skipping some paragraphs:

"Despite all of the suggestions that were conveyed to the committee that no adequate provision was being allowed as an incentive for efficient production, none of the contractors who appeared before us made out a case of insufficient reward by the price adjustment boards for the performance which they had rendered.

These are but some of the reasons that make it impossible to devise a formula with universal application. In truth, renegotiation is the conscience of procurement. The reasons for its existence are the same that produced equity to ease the rigidity of the common law. The pangs of conscience vary with circumstances. So with renegotiation. Renegotiation was born in a moment when the people were indignant

at the existence of unconscionable profits. The mood and temper of the public was such that there was little time to do more than issue a bill of attainder for such unconscionable profits. In the more than a year that has passed since the enactment of the law, the Price Adjustment Boards have had occasion to examine many cases and have established to their own satisfaction the guideposts which are to them the indicia of the existence or absence of excessive profits. They have very properly made known to the public those guideposts and have announced the factors which control their determinations. We think that those factors should be written into the statute so that it may no longer be said that the fate of a contractor about to be renegotiated rests not with the law but with man alone. For this purpose, it is recommended that section 403(a)(4) be amended so as to provide that in determining what are excessive profits, the Secretaries shall be required to take into consideration the factors which have been enumerated above. Efficient production, low cost of operation and accelerated depreciation are factors to which specific reference must be made in any such amendment."

Then there is a section on "Disclosure by the Price Adjustment Boards of the Factors Affecting Their Determination in Particular cases." It is on page 39.

"One of the principal complaints which has reached the committee from contractors who have been renegotiated by the War and Navy Departments is the fact that renegotiation proceedings are shrouded in secrecy. They are not told the reasons for the determination in their cases, nor are they given information concerning the profits allowed to their competitors. They are unable to judge how the settlement that is proposed to them compares with the settlements which their competitors received or whether in fact they are receiving the additional allowance for superior performance which the Boards have in some instances indicated to them that they were receiving. They have indicated a belief that

some of the more sinister aspects of renegotiation would be eliminated if it were an open and public proceeding, and if the veil of secrecy were torn from the settlements reached. The complaints of contractors in this regard have not been directed to the Maritime Commission Price Adjustment Board, which follows the contrary practice and in fact, when renegotiating a case, advises the contractor of what his competitors have received and explains the basis for any difference in treatment.

With neither a formula nor other decisions available for them to measure the fairness of the determinations made in their cases, it is no wonder that business men experience a sense of bafflement at the operations of the renegotiators. Concealment is bound to engender suspicion, but suspicion in turn can be destroyed by full disclosure. We think that there should be no secrets in connection with the expenditure of public funds. If a factor is sufficiently important for the Government to allow a contractor a higher profit because of it, it has sufficient importance for the public to know about it. That industry as a whole would prefer to have the results of renegotiation a matter of public record, as a guide from which they may be able to determine the Boards' probable performance in respect to their own cases, is apparent from the testimony which we have heard and from the letters and memoranda filed with us. We think that if an agency of the Government is to have the power to recapture profits which a contractor has made on Government contracts, that agency should be obligated to state the reasons upon which it based its conclusion that such profits were excessive.

Such a requirement is not unreasonable. Unless the Price Adjustment Boards go through some process of reasoning in arriving at their conclusions, their determinations are subject to the suspicion of being unfair and being improperly arrived at. Once the reasoning process has been concluded and the determination reached, there is little effort required to

prepare a summary statement of those reasons and of the decision."

Now, it seems to me, if your Honor please, that that report makes it clear that this act as it existed before the 1943 amendment had set up no standards. This pamphlet, "Principles and Policies of Renegotiation", to which the court in *Spaulding v. Douglas Aircraft* refers, does not itself set up any standards. It may have been incorporated in the statute. Those principles were still open to be changed at any time, and they expressly so provided. When we get to the joint statement of general principles to be followed, we find that of the general principles followed in determining excessive profits the second one was:

"Reasonable profits in every case should be determined with reference to the particular performance factors present without limitation or restriction by any fixed formula with respect to rate of profit or otherwise."

At least until the amendment of 1943 it was clear apparently to all the members of Congress that no standard was set up, that renegotiation might be carried on as though it was in secrecy, that the renegotiators might consider evidence not to be disclosed to the contractor, and to make their determination of the ultimate fact without any findings whatsoever. That means in effect that a determination by a renegotiating agency, even if standards had been set up, would be left as a practical matter to the unfettered discretion of the renegotiating agency, because no contractor could know that any particular standard had been applied or followed. Even if there had been a yardstick, how would the Alexander Wool Combing Company know from that unilateral determination that the standard had been followed?

The Court. If your client got less than the rate of return on its operations that it was entitled to under the constitution as applied in public utility cases, would your client in your view have any remedy outside the remedy in The Tax Court? Do I make myself clear?

Mr. Park. Yes. That of course is principally the second point.



The Court. That is true of the first point as well, because I want to find out whether there isn't an implied standard that says that an excessive profit was not earned when less than a constitutional rate of return is achieved by the company whose profits are in question.

Mr. Park. There are a number of difficulties in answering that question, because there are some assumptions in it of which I have doubt. I don't know that there is a constitutional rate of return in the wool combing business. Certainly there must be businesses on which there is no constitutional rate of return, where the risk, for instance, is so great,—I happen to know something about top making because I represent some top makers too, and they buy wool in Australia which may be delivered to them six months later, and the price of wool—that is, under war conditions—the price of wool fluctuates and that part of their function is just taking risks.

The Court. Suppose A signs a contract with the Government of the United States and A contracts to buy from B as a subcontractor \$100,000 worth of wool, and B actually paid for that wool \$110,000 but is selling it for \$100,000 to A, and by some queer freak the secretary of war initiates proceedings against B, the subcontractor, and determines that there were in that transaction excessive profits, where there could not have been any excess profits. Under those circumstances wouldn't B have an opportunity to challenge the findings of the secretary? And would B have that opportunity to make the challenge outside of The Tax Court?

Mr. Park. The statute says that The Tax Court is given exclusive jurisdiction of the amount of excessive profits. If the statute is valid I suppose there is no right of judicial review in any other court because the statute says otherwise.

The Court. If I may interrupt you,—

Mr. Park. I don't happen to think the statute is valid.

The Court. I should think that a tax court is not a tribunal in the true sense of the word "court", and I should suppose under the older cases—query about the more recent ones—where a ques-

tion of confiscation was at stake, you were entitled to review in an Article 3 court.

Mr. Park. I agree with your Honor. I think the statute is invalid because it attempts to take away any right to a judicial determination as to whether or not an order under the Act is confiscatory.

The Court. And whether any court or administrative agency could find that a rate of return was an excessive rate of return or an excessive profit if the rate were in fact lower than the constitutionally required rate of return.

Mr. Park. My difficulty with that is that I don't know what the constitutionally required rate of return to a combing mill is.

The Court. We know that before that *United & Electric Company Railways v. West* was decided in 280 United States, that the rate of return on a public utility was less than the constitutionally authorized rate of return, and it had been 4 per cent.

Mr. Park. I frankly have assumed that if you are running a combing mill and selling at fair prices in a normal competitive market, that there is no such thing as excessive profits, so that the constitution—at least the constitution guarantees you what you can make.

The Court. You mean to say that it is unconstitutional for Congress to provide that nobody can make more than 25 per cent in time of war?

Mr. Park. No, I don't say that, but we have not got any such limitation here.

The Court. No; but I am just challenging what you say.

Mr. Park. I have been speaking, if your Honor please, about the secrecy.

The Court. Secrecy?

Mr. Park. Yes, that enshrouded the administration of this Act from which I have just read you excerpts from the House Report, the fact that no statement was furnished us although our affidavit shows we requested such a statement. We requested a statement of the facts that were to be reported to the under secretary for his determination and they were refused us.

The Court. I thought the point which you were making was that there was no adequate standard for the delegation to the secretary or to the various departments because the words "excessive profits" had no meaning.

Mr. Park. Yes, I was making that point, and I was going on a little further to the point that even if those words did set up any standards, we don't know what they are, they are not disclosed to us, and the application of them is not disclosed to us. So that we come to the point that was made in the Panama Refining case, that where the application of standards to a set of facts is committed to some administrative agency, the statute should provide that some finding should be made, and that the statute may be invalid on that account, the point being that—

The Court. I had thought the question of finding in connection with this kind of proceeding, while it may have been called for by the reasoning in Panama Refining *v.* Ryan, certainly was never called for in any other case, and that there have been subsequent cases like the Cotton Mills case and the cases which arose in connection with the National Labor Relations Act which make it quite plain that Panama *v.* Ryan does not mean all it seems to mean.

Mr. Park. I venture to disagree with your Honor. I think what Panama Refining Company *v.* Ryan means is that at least when there are very broad standards there must be findings. Doubtless if the standards are very narrow and the finding of the ultimate fact necessarily requires a conclusion that those narrow standards have been met, no findings may be required, but where you have a statute which sets up, as we think, no standards at all, or at the very best the broadest possible standards, then if we are to know, if Mr. Alexander and the other people interested in the Alexander Wool Combing Company and the public are to know that the renegotiating agency, the man to whom the power had been delegated, was not using his unfettered discretion, acting, not on the basis of standards set up by the statute or standards set up by regulations or standards set up by any public authority, but merely at some whim or caprice of his own, there should be findings.

The Court. Would it be fair to say that findings are ordinarily required where judicial review upon a record is sought? A requirement for finding is a requirement made to enable the court on review to test the soundness of the administrative result. In this case since there may be no judicial review but merely a trial in the Tax Court or a suit in the District Court upon the determination, there is no occasion for a finding. Is that a reasonable approach?

Mr. Park. That is a reasonable argument. I don't have to agree with it. I think the findings are much more important than that. I think the findings are something that the citizen is entitled to. He is entitled, when the law comes to him and says, "You owe so much", to know why. It doesn't just come out of a pronouncement from some room from which he has been excluded.

The Court. Have you ever heard of a finding made by a selective service and training board with respect to whether a particular person shall or shall not be drafted, and if he is drafted he is to report on such and such a date?

Mr. Park. I know very little about the Selective Service Board, but I understand there are findings made by the board. The findings at least consist of those that you make and refer to in your papers going back to the review board.

The Court. With a vote of the board.

Mr. Park. Yes. We don't even have that here. That is what I asked Major Lucas for. I said, "Let me have the report you are going to give to the man upstairs." We didn't get that. As the result of these recommendations in the House Report the Act as amended in 1943 did require some findings. They required a statement of reasons to be given, and at the time I was talking with Major Lucas that act was in effect. He said it was not applicable to years ending before June 30, 1943, and it was not the policy of the War Department to give any statement of reasons if they didn't have to.

The Court. Is that any different from the ground in this case, that if you are not satisfied with the result that the secretary of war had arrived at, you are entitled to tear up the whole proceed-



ings and start over again in The Tax Court? That is, if you want a finding you can have it.

Mr. Park. Yes, in a tax court. The question is when a liability is created. This Act attempts to create a liability when the secretary makes an order,—

The Court. Yes.

Mr. Park. —and it creates a liability under a statute that I say sets up no standards, but if it sets up any standards it allows the secretary of war to create such a liability without any statement of the facts or the principles which he applies, and the application to a tax court does not stay the execution of that liability. It may be enforced immediately.

The Court. I don't know whether it does or does not. That is a somewhat different question. I wonder if, for example, you had applied within ninety days to The Tax Court and then you filed some kind of a dilatory plea, or if you filed some kind of an equitable plea, whether you wouldn't be able to delay?

Mr. Park. I might be able to appeal to the conscience of a judge, but suppose contractors withhold money that is due me and pay it over to the United States. That is what usually has happened, and they haven't waited for any ninety days to do it either, so the order isn't stayed in a court. I may appeal perhaps to the conscience of a judge, but in the statute the statute says the filing of a petition shall not stay execution of the order.

The Court. You would have a very pretty case if the prime contractor turned the money over to the Government instead of turning it over here while you had a suit against him pending in The Tax Court.

Mr. Park. We are not in a position to answer that. I will get through with standards in a moment, but I would like to read you a little bit from the statement of Honorable Robert P. Patterson on September 20 and 21, 1943, before the Committee on Ways and Means. On page 814 the Chairman asks:

"The Chairman. You do not have any formula, as I understand it.

Mr. Patterson. That is true.

The Chairman. Each Board is a law unto itself.

Mr. Patterson. We do have no fixed formula; that is true. We have tried to frame one, but we cannot, and I do not believe anybody can."

On page 834:

"Mr. Disney. Let me ask you, are there any standards at all in this statute for the determination of excessive profits?

Mr. Patterson. No specific standards."

And then a little later on he says:

"There is nothing very unique about this particular phase of it that we are discussing now. There are no standards set there except the standard that it shall be fair and just."

The Court. Do you think it makes any difference that what Congress is trying to get at is a reduction of excessive profits made as the result of expenditures by the United States? In other words, could there be a difference in the rigidity of standards required where the legislation is aimed at excessive profits earned to expenditures of the United States rather than excessive profits earned to expenditures of third persons in the ordinary course of trade or industry?

Mr. Park. It might. As I pointed out to your Honor earlier, there is no evidence that there were expenditures by the United States in this case or that they paid any more. That was not considered. A statute might be drawn and so framed as to seek really to recapture expenditures by the United States, but this statute does not do it. This statute is broader than that. This statute covers just excessive profits.

The Court. You mean they could recover excessive profits I make, for example, in connection with the sale of some books I have in my house to some book dealer?

Mr. Park. No, I don't say that.

The Court. It has to be in relation, doesn't it, to a subcontractor of the United States?

Mr. Park. Yes, but the subcontractor might sell to the con-

tractor for \$100,000 and have a profit of ten. The contractor might then sell to the United States for ninety, and there would be no expenditure by the United States. It would have cost them nothing. The statute does not discriminate, it does not go into the question. There is no rule attempting to trace money of the United States into a subcontractor. You merely look at the subcontractor and say, "We estimate that the end use of your work was procured by the Government, and we allocate profits and decide you made too much."

The Court. I am not going to interrupt your argument further, but I do at this time want to call attention to the point that you tried to emphasize, that there is no statement in the complaint or in the exhibits as to the determination of excessive profits—

Mr. Kobrick. Doesn't your Honor desire to have that answered immediately? I think there is an answer to it.

The Court. Not now.

Mr. Park. In fact my point is not as broad as that. I say there is nothing to show the Government paid too much money because of any profits made.

The Court. I thought you went so far as to say it doesn't show the Government paid anything on account of these contracts.

Mr. Park. I don't know how the Government knows we did, if we did. The unilateral determination starts off:

"Whereas Alexander Wool Combing Company holds contracts and subcontracts subject to renegotiation pursuant to the provisions of Section 403"—

There is that conclusion. There is no statement of any fact and whether or not that conclusion was right depended upon the construction of law with which we did not agree and which we have made clear I think in our answer we did not agree to. It is perfectly clear we did not hold any contract. That is shown in the testimony.

On page 838, Mr. Disney speaking:

"This statute is almost as broad as the Congress writing a letter to the War Department and saying, 'Go to it and

collect the excessive profits in any manner that you see fit and to the extent you see fit—is it not, unless there are standards to guide you?"

Mr. Patterson said:

"Well, there are no standards in it except the standard that it shall be fair and just, and I do not know what else you could do.

Mr. Disney. I do not want to pester you about it.

Mr. Patterson. I do hope there will be no efforts made, though, to write into the law a lot of conditions and restrictions and provisos and standards, and so on, because I am afraid it will be unworkable if we do."

And then on page 870, Mr. Lynch speaking:

"Mr. Lynch. Now, if you have a formula, or if you have a standard, or a sum whereby you could work out such a formula or such a standard, that would in effect bring us back to just exactly where we do not want to be, that is, the cost plus, would it not?

Mr. Patterson. If there could be standards fixed that were workable that would fit all cases, I would be glad to see them set. I have had some of the men in whom I have the very greatest confidence try to develop such standards, and it seems clear as a result of the whole thing that you could not do it and Congress has not done it in case after case, in other laws. It has always used the words 'Compensation fair and just, prices fair and reasonable.' That is what we are trying to do now."

Now, I have said to your Honor that under that broad definition excessive profits are what you find to be excessive profits. Mr. Patterson and other persons to whom this power to renegotiate was delegated could find that people who sold at the fair market prices had realized excessive profits, and, having found so, impose sanctions upon them, a penalty in the form of some amount which in their opinion represented excessive profits. If your Honor



please, I think that goes beyond the power of Congress. I don't think that Congress itself could have said that a man realizes excessive profits at fair market prices. Your Honor asked me that question a few moments ago in a little different form and I think I answered it in the wrong way.

I say that Congress could not pass a law saying that a seller who sold only at fair market prices and received only just compensation should be penalized if he realized profits in excess of 6 per cent or in excess of 25 per cent or in excess of 50 per cent. In other words, I think that under the Fifth Amendment which entitles you to just compensation, if I own a piece of property which I bought perhaps ten years ago at 10 cents on the dollar, its present value, I have a right to a dollar. Perhaps the just compensation clause ought not to be in the constitution, but I think that is what it means. It is perfectly clear that if the property were taken, requisitioned, that I would be entitled to my dollar although what was taken cost me only 10 cents. It cost me only 10 cents because for some reason or another I had some special advantage and I am entitled to my property and to receive just compensation for it, and I do not believe that Congress itself could indirectly prevent me from receiving it by saying to me, if I sell it, then I may be penalized in some amount. In other words, Congress cannot ask for less than the fair market value. I don't think it can coerce me into selling at less than fair market value by exposing me to liabilities such as this one for excessive profits.

The Court. Does the statute in the District of Columbia provide that no money lender shall charge more than 6 per cent interest? If in fact it is a loan carrying a higher rate of interest, it involves forfeiture by him to the United States for such excess interest?

Mr. Park. Yes, sir. I have no quarrel with such a statute as that. That prevents you from going after contracts,—your property is not being taken. If it is said to me, if an act should say that I have to loan money at—

The Court. There is nothing that says that the subcontractor has to sell to the prime contractor except a provision, which is not here involved, that provides that under such circumstances if

the Government does take it, it must pay just compensation,—Section 9 of the Selective Service and Training Act, or some such law.

Mr. Park. There is a repricing statute.

The Court. Another one?

Mr. Park. Yes

The Court. That is not here involved?

Mr. Park. No, it is not here involved because we did not sell to the United States, nor even to persons whom we knew had contracts. We simply sold in the open market to people whom we expected might ultimately use the benefits of our service, and in the long run the end use would be for Government contracts, but we did not voluntarily subject ourselves in any way to this renegotiation act. I say if the purpose of the Act is to coerce us to sell at prices reduced below fair market value, if you define a profiteer as including a man who insists on just compensation, or define excessive profits as including profits realized by sales at just compensation, then I think you are avoiding the just compensation clause of the Fifth Amendment. I think any such act as that is an indirect attempt to evade the provisions of that Act. I have covered that in a supplemental memorandum. I have probably been too long anyway, but I told you I wanted to proceed slowly and painfully. The second part of our argument is that even if the Act is valid, the determination of the under secretary was made without due process.

The Court. Can that be raised in these proceedings?

Mr. Park. I think that is the question. The whole point is, I think, whether or not we are barred by some rule that we should have gone to The Tax Court. I say apart from that rule I think there probably was very little dispute about the fact that we did not get a fair hearing.

The Court. Let us take the most grievous case. Let us assume that there was an error on the part of the officials. Could you show that from these proceedings?

Mr. Park. I don't think so, and I don't think that is the most grievous case. I think the most grievous case is this case where we go into what is supposed to be a hearing with no issues.

The Court. Oh, yes.

Mr. Park. I don't mean in this case. I mean before renegotiators. We could call that no issues. They simply look at our figures and ask us to step out of the room, and we come back and they say, "We want you to refund so much." That is the first point at which the issue arises. You ask, "Well, how did you determine that we owed so much money, that there were excessive profits?" "Well, we considered a lot of factors." "Did you consider other evidence?" "Yes; we took those factors and compared them with what other contractors were doing." We say, "Oh, you didn't let us know about that. We would like to see what you had, what your figures were. We think perhaps we can show something to show that you have misapplied those factors."

The Court. You had a right virtually to wipe the slate clean in those proceedings, didn't you?

Mr. Park. That is the real issue, your Honor. All I am saying now is that the hearing board or adjustment board was—

The Court. Arbitrary?

Mr. Park. —arbitrary, and the worst sort of hearing. If it were not for this right to petition to the Board and have appeals, I don't think even my brother would be in here saying that suit could be brought on this unilateral determination. If he did have to, he would hate to do it. So I say that the real question is, is there a rule that fits such a case as this, that when we are sued on a unilateral determination, when we have done nothing,—

The Court. May I draw to your attention a more drastic case, in which unfortunately I was a participant, the case of Yakus case against the United States, in which the men were sent to jail? The men were sent to jail for six months for violation of a regulation which was invalid. I did not know it was invalid, and the men were not allowed to show me it was invalid. The regulation was adopted by the Administrator by the specific rules of statute which take into account certain economic considerations which he did not take into account, and yet it was held by this court and by the Court of Appeals and by the Supreme Court that the man had no right to raise in this court or in the Circuit Court of Appeals

or in the Supreme Court the validity of the regulation or the means by which the Administrator arrived at his conclusion; that his only chance was to go to the emergency court of appeals set up under the statute; and if he didn't do that he ran the risk. Isn't that your case, only not quite as bad a one?

Mr. Park. No, I don't think so. In the Yakus case it was perfectly clear that the hearing provided by the statute, while it was a difficult hearing to get in the emergency court of appeals, you were not entitled to it until afterwards.

The Court. Until after what?

Mr. Park. After the validity of the regulation or the order, but a hearing was not a condition precedent to the regulation.

The Court. That is right.

Mr. Park. In this case we are proceeding under the Act of October 21, 1942, which did not provide for any petition to The Tax Court. That was provided, permission was given by the 1943 Act which came later.

Now, I take it that some hearing was required under the Act of October 21, 1942, and that the hearing must be held under that statute prior to any unilateral determination, so that we have at least this difference between those two cases, that in our case a hearing was under the statute, under the frame of the statute a condition precedent to any effective order. In the Yakus case it came afterwards. Therefore, when we have, as we have here, a unilateral determination which I think on its face shows that there has been no adequate hearing, no hearing within the safeguards of the Fifth Amendment, that the unilateral determination shows on its face that it is nullity. The unilateral determination in the first place omits a great many statements which I think ought to be in it, and then it says:

"Whereas, as a basis for said renegotiation the Under Secretary of War considered certain financial, operating and other data, submitted by the Contractor or obtained by the Under Secretary of War from governmental or other reliable sources, relating to the profits realized by the Contractor during said fiscal year under said contracts and subcontracts."



Of course those words "or obtained by the Under Secretary from . . . other reliable sources", do not necessarily exclude the idea that they were submitted at the hearing at which the contractor was allowed to participate, but I think they do, if your Honor please, in view of these principles and policies of renegotiation and the joint statement which disclosed that the figures from other contractors were to be considered and were not to be submitted to the contractor.

I think this unilateral determination is not to be read without some regard to the whole administrative practice recited over and over again in the various orders and directives that were gotten out by the War Department. It is perfectly clear, everybody knows, and it is admitted in this case that the Department did consider evidence not submitted. Major Lucas in his affidavit admits that, and the administrative practice that was admitted connected that whole background of the administrative practice, and with those in it is enough to show he considered it and based his judgment upon it. Therefore it seems to me that the order itself bears witness that this requirement of due process that decisions, orders and determinations be made upon evidence fairly disclosed to the person who is entitled to the hearing has been violated.

Therefore the proposition on which we rest is substantially this: that where an attempt is made to enforce in court by the United States a determination by an administrative agency, which, under the terms of the statute authorizing such a determination had to be made after hearing and not before hearing, and where that determination shows on its face that it is void—

The Court. Does the determination show on its face that no hearing was held?

Mr. Park. It shows that a hearing was held at which the under secretary considered evidence not disclosed to us at the time.

The Court. Oh, yes. The third recital,—is that what you mean?

Mr. Park. Yes, that is the one:

"Whereas, as a basis for said renegotiation",

which under the terms of the Act includes fixing the price.

The Court. You mean just exactly as though it said, "Whereas, after discussing the matter with the Chairman of the Democratic National Committee I have determined"

Mr. Park. No, not exactly. I wish it was as good as that. Suppose he had said that, or said just bluntly and plainly that I had done something arbitrary, utterly arbitrary, and then I go into court with that order and say, "Your Honor, I want to enforce it." You can go to The Tax Court if you want to, but as I understood this rule about exhausting your administrative remedies it was this,—and this has been settled over and over again, that is the way the rule is usually stated,—a man cannot come into equity and ask the aid of a court of equity unless he has first exhausted his administrative remedies. That rule I understood was merely a corollary of the general rule that a man could not come into equity if he had an adequate remedy at law,—

The Court. You can't come in and get a declaratory judgment if you have the remedy in The Tax Court.

Mr. Park. That is right, but declaratory judgments are equity practice.

The Court. Yes.

Mr. Park. Now, there are apparently some recent cases which relax that rule. I have not read many of them, but one of them is *La Verne Co-Operative Citrus Association v. United States*.

The Court. That is a United States Supreme Court case?

Mr. Park. No. It is the Ninth Circuit.

"The doctrines of primary jurisdiction and of administrative finality are equally persuasive where the issue is raised by defending parties as where it is raised by moving parties."

I have not found that said very often.

"A consideration of the defense in an enforcement action would nullify the uniformity achieved by devising a single procedure for testing orders promulgated in accordance with the terms of the Act."

And then in parentheses:

"(Again we note that we are not discussing invalidity apparent on the face of such orders.)"

So that so far as I know this idea that if you are a defending party and you are confronted with an order made that would require hearing arbitrarily, the burden is necessarily upon you to exhaust your administrative remedies,—I say I do not think there is any case holding that where the invalidity is apparent upon the face of the order itself.

The Court. Of course this third recital does not really say that the evidence so obtained was not shown to the company in question.

Mr. Park. No, it does not. If it said that, then I think I would have your chairman of the Democratic Party case, but I think your Honor must read that unilateral determination, not just by itself, but with the administrative practice behind it, with all the information as to it which is available to you, and if so read this would mean just what it does mean in fact, because it does mean that in fact, and was put in there to mean that. It was put in there to mean that we consider not only the evidence submitted by the contractor but other evidence that we get from other reliable sources, and that was not disclosed to us. Therefore I say I think this bears on its face, in the light of the administrative practice, evidence that the hearing which was a condition precedent to this order had never been held. I think that is my argument.

The Court. Thank you. I might say you have illumined the subject considerably and I am much more disturbed than I was before you began.

#### ARGUMENT IN REPLY BY Mr. KOBRICK.

If the court please, I should like first to talk about the rather general proposition that Mr. Park discussed, and that is the nature of renegotiation. I think that he has the idea that renegotiation involves sanctions or penalties against wrongdoers.

The Court. I don't understand that is what he means, and of course it is not so. He meant sanction of an enforceable claim.

Mr. Park. No; more than that.

The Court. Did you mean something more?

Mr. Park. I think it is in the nature of a penalty.

The Court. In a colloquial sense, but not in a criminal sense.

Mr. Park. Yes, sir.

Mr. Kobrick. I think it would be fair to describe renegotiation as no more than a recapture of any amount which is found excessive.

The Court. How about that phrase?

Mr. Kobrick. That the Government hasn't paid the bill. I think there isn't very much doubt that the material which is available by judicial notice will demonstrate that that is not so, that the Government does pay the bill, and the Government is operating precisely on that theory.

The Court. And you also say what Mr. Park said was the case, that the Government paid more than the excessive profits of Alexander?

Mr. Kobrick. Not in those precise terms, but I think in general operation that would be so. The order is attached to the complaint and itself recites that \$45,000,—I am looking now at the order of 1943, but they are both alike,—"\$45,000 of the profits realized by the contractor during its fiscal year ended 30 June 1943, under its contracts and subcontracts subject to renegotiation pursuant to the provisions of the Act, are excessive." That throws us back to the statement that shows interrupted contracts with the department, and subcontracts.

I would like to go into the accounting technique briefly which was utilized in segregating the war business from civilian business. This is a good illustration of the more difficult type of case, and by no means an unusual situation; that is, that there is no earthly way of demonstrating to the last penny where the wool went with any accuracy at all. The best that can be done is to apply reasonable regulations designed to arrive at a sensible result. The regulations which are set up and published and available to the court provide varying methods for doing just that, with the aid of the records kept by the contractor and its customers. They provide also this, that if the contractor believes that the result



reached by these general methods is not a correct statement of his own war business, he is entitled to make any showing that he is able to make as to what is a correct statement and that will be accepted as fair. So that what we have in substance is some presumption created by regulation as to what is or what is not paid for by the Government, with the right on the part of any contractor engaged in renegotiation to rebut those assumptions.

The Court. As I understood in this particular case Alexander was given a result and was not given both reasoning and evidence.

Mr. Kobrick. There is no question about the extent of the discussions relating to the issue and what was and what was not subject to the statute, and the information which was used for arriving at that conclusion was the information submitted by Alexander. What was done was this, and this is all set forth in the Lucas affidavit detailing the proceeding.

The renegotiation officials permitted Alexander in the first place to segregate his business as between war and non-war. That is the general practice. There is no attempt by Government officials to make any independent investigation of that sort of question. Alexander correctly pointed out that they did not have records which would enable them to state with precision what that was. They were then shown a regulation which specified in substance that they were to go to their customers and ask them what proportion of the goods which were shipped by them to their customers had a war end use, and by that process the figures were finally arrived at by which the segregation between war and non-war business was computed.

All of that was done in the open, and most of it was done directly by Alexander. And I might say that that is a fairly typical situation in the renegotiation of subcontracts. The Hirsch affidavit goes into the administration problems at some length. I think I need not add at this point to that.

The question your Honor asked, using as an illustration the sale of steel by United States Steel to Bethlehem, intended to go into a ship owned by the United States and not so used in fact,—the answer is that so far as that so far as administrative interpreta-

tion is concerned that is a subject of renegotiation. The test in every case is the actual end use so far as it can be determined.

The Court. Do you have to show complete determination, or do you have to show in the District Court in a suit upon determination the end use and the end use by the Government of the United States?

Mr. Kobrick. I think I should say first that the determination does show the ultimate conclusion. In the paragraph I just read that says that it is the Government end use subject to the statement that I think could be fairly drawn from the fact that this is the secretary's order, it is the secretary's regulation construing the statute, so reading the two things together that must be the meaning.

Certainly we think it is not open to us to show in the District Court that the actual end use was a Government end use. That is a question for The Tax Court exclusively. On no construction of the statute could that be taken from The Tax Court, and I think clearly enough on the last decision of the Supreme Court on tax court jurisdiction, much more on bare questions of amount.

Mr. Park addressed himself to the difficulty of defining the word "profit". I had not gone into that. I had confined myself in the first place to the difficulties as we saw them stemming from the fact that the word "excessive" was not defined. I assumed that "profit" gave no trouble and I arrived at that conclusion because the statute instructs the renegotiation officials to compute profits in the following way. They are to take total receipts and subtract from that the costs allocable to those receipts. The costs are to be determined by the methods prescribed. I should say first disallowing any unreasonable or excessive costs or salary, and that question is to be determined with the aid of the Internal Revenue Code which provides for comparable problems in the tax field.

The Court. The problem is ultimately the same as net income?

Mr. Kobrick. There may be further complications in the tax law, but certainly it is at least as simple as net income. It seems to us the only place where there is room for judgment by the ad-

ministrative officials as to what is profit is the question of allowing or disallowing costs, and a short guide on that is the Internal Revenue code that I suppose is the most elaborate description of that question known to the law.

The Court. Now, will you come to the point that I put to Mr. Park about the constitutional rate of return?

Mr. Kobrick. I think if there is such a problem, there is nothing in this statute, certainly nothing involved in this proceeding which gives any trouble. The statute does make final and unreviewable a determination by The Tax Court of the amount. And if we take a case in which that procedure has been exhausted and at that stage the contractor contends that the order there entered is so exorbitant as to reduce his compensation below constitutional requirements in terms of the concept of confiscation in rate cases, I would say that, first of all, the answer to that must be that every statute must be read with the constitution.

If his statute in its finality provision is so broad as to preclude judicial consideration of that claim, and if judicial consideration of that claim is a constitutional necessity, then the obvious result must be that it will be ineffective to accomplish that purpose and that judicial consideration will be forthcoming, not automatically, to be sure, at an appropriate time by The Tax Court.

Let us assume we are here today debating an order of The Tax Court rather than one of the under secretary of war, and let us assume further by way of contention, which I have never seen made in a renegotiation case, that the order reduced the profit to so low a figure as to amount to confiscation. This court would then have before it, I take it, the following questions:—The first is the claim of confiscation—I had better put these in different order. First, is the statute sweeping enough to prevent in terms consideration of that claim? If it is not, I suppose that would be the end of it and that question would then be considered. But suppose it is, does that law violate any constitutional right? And if the answer to that is in the affirmative, then the separability clause of the renegotiation act must necessarily result in this court

refusing to give effect to the finality provision and nothing more *pro tanto*.

The Court. Perhaps I have put a question that is not realistic to Mr. Park. You say your client got less than the constitutional rate of return?

Mr. Park. No, I don't. I don't say the constitutional rate of return.

Mr. Kobrick. I think the Navy Department has been sufficiently generous.

Mr. Park. If I am asked about that, then I have got to say definitely that they were certainly not allowed enough.

The Court. You were not allowed enough?

Mr. Park. No.

Mr. Kobrick. I have seen lots of cases like that. I think we mentioned before in those cases in which a finding was made they were excessive profits and 97 per cent were settled by agreement, and apparently rightly. Perhaps we are not doing full justice to all the war contractors.

Mr. Park made some reference to that Vinson bill and the profit formula which it contained, and to a good deal of discussion in the legislative history as to whether there was or was not a formula, whether there could or could not be a formula. I think many times the people who were talking about it said standards when I think they were talking about formula. It is perfectly clear the word "excessive" is a standard. Whether it satisfies Mr. Park as to its sufficiency is another matter.

Experience under the present bill is illuminating. That was an attempt to limit, in a narrow field of defense procurement contractors, profits to a fixed percentage, and that was scrapped when we got into hot water during the last definite pre-Pearl Harbor stage. It was an impediment to procurement because of its rigid controls.

The Court. In practice what is excessive, anything between five and sixty per cent?

Mr. Kobrick. I think the range has actually been very much narrower than that, but there have been substantial differences as I



understand it in percentages allowed. The services have never adopted any formula any more than the statute has.

The Court. How has it worked out? Has anybody been allowed and paid 50 per cent profit?

Mr. Kobrick. I never heard of such a case.

The Court. Has anybody been allowed and paid 10?

Mr. Kobrick. Yes.

The Court. Has anybody been allowed and paid 20 per cent?

Mr. Kobrick. I think possibly a few.

The Court. What does the Truman Committee say?

Mr. Park. 22 per cent in the War Department. They run from 4/10 of 1 per cent up to 22 per cent. The Navy Department runs from about 5 to 17. They pointed out that the Navy Department and the War Department had different principles.

Mr. Kobrick. Well, I will come to that.

Mr. Park. Anyway, there are some statistics on it, if your Honor really wants it.

The Court. I wanted to know what the return was, and apparently the answer is less than 1 per cent to 22 per cent.

Mr. Kobrick. I think along with that it might be borne in mind, those statistics that Mr. Park was looking at also indicate the percentage of cases which fall within the practice, and there has been a heavy collection of cases. Mr. Park put considerable emphasis on the Truman Committee requirement or Truman Committee criticism of the administrative failure to inform contractors as to why they fixed the profits at the particular figure which they chose, and Congress followed that recommendation in the 1944 amendment and made that a requirement, to comply with such a request whenever made in the later years. I take it that that was a perfectly legitimate conclusion by Congress that it was better practice and better public relations to do it that way, but I don't suppose there is anything in the constitution that bears on that.

The Court. About the point Mr. Park made in the Ninth Circuit case, Mr. Park said that what the Ninth Circuit ruled was really unsound because prior to the amendment of the renegotia-

tion act there were half a dozen different standards supplied. There were formulae or rules applied by the War Department, by the Navy Department, by the Maritime Commission, and so forth, and you couldn't tell which, if any of them, were ratified by the subsequent Act of Congress which amended the Renegotiation Act.

Mr. Kobrick. I have been dealing with renegotiation cases in the courts for about two years.

The Court. To show the benefits of that, I am sure this was not the first time you have argued it.

Mr. Kobrick. Whatever knowledge I have about it stems from that source, and I wouldn't want to say that I know for certain that there never was any conflicting statement of policy formally issued and published by any department during the period of the War Department's individual release and the joint release of the next spring, but I have never seen any such animal. The only thing I have ever seen in writing is the War Department's release of August, 1942, followed by the joint release of the several departments in March of 1943. I take it that what the Truman Committee was talking about was contractor testimony that the War Department did one thing and the Navy did another and the Maritime did still another.

The Court. Is that true?

Mr. Kobrick. In terms of policy. I know of nothing to support it. The subject matter of the contract which the Army has to deal with is not the same as the Navy. The Army's "procurement needs" cover a very much wider range in types of product, so that the extremes may well be accounted for by a typical situation that the Navy only has had to contend with. That is the implication that occurs to me based on such information as I have picked up along the road as to Navy and Army procurement.

The Court. From such information as I have picked up along the road I have understood it was quite different whether you go to the Navy or go to the Army, and that the same company has very different experiences.

Mr. Kobrick. I don't know where that specific information comes from.

The Court. Along the road.

Mr. Kobrick. Along the road. I can only say that one thing is plain, the Army's procurement during the war has vastly exceeded in dollar amount the Navy's, and also vastly exceeded in variety of items what the Navy was purchasing. As a matter of fact the Army renegotiations in the period before it was all put under a joint board reflected that. By far the preponderance of renegotiation was in the Army board.

There was some discussion about a stay pending a tax court proceeding. Assuming Mr. Park were now in The Tax Court and we were here, there is a refund provision,—I shouldn't call it a refund provision because it is not so phrased,—there is an appropriation which was made available last April or May for refunding any amounts finally determined to have been erroneously collected, so that that provision would afford some relief, and it is provided that that is to be with interest. Quite apart from that the statute provision as to stays is a limited provision. What it says is that the filing of a petition in The Tax Court shall not stay collection.

The Court. You mean to say that if the secretary of war had made one of these determinations and the very next day Mr. Park filed in The Tax Court and you filed in this court, you could go ahead and get judgment in this court?

Mr. Kobrick. No, your Honor. I was coming to that. I was about to say this, that as I read that provision it means that the filing of a petition in The Tax Court does not automatically. I think that is the conclusion one would have to reach in the light of the decision in one of the broadcasting cases.

The Court. You mean in two cases where two companies file, both claiming the same wage rate?

Mr. Kobrick. Mr. Justice Frankfurter referred to a statutory provision like that and reviewed all the statutes in which there was some type of stay provision, and pointed out that when Congress made no stay, no authority in the court to grant a stay, they said there shall be no stay, as distinguished from a case in which they merely said the filing of a petition shall not stay, and the

Government has taken this attitude in other cases where it was involved, but it isn't here, that if the contractor wants his District Court case stayed pending a tax court proceeding, we would not object to it. We would insist on one condition and that is that we be secured, because in a great many of these cases the war profits are being dissipated very rapidly and if we waited indefinitely we simply would have an empty judgment. So far as reducing our claim to judgment is concerned we certainly have no objection whatever to postponing adjudication of the question in the District Court until after The Tax Court has finally settled the amount. Mr. Park made some reference to the power to withhold—

The Court. You say you have the right to withhold anyway to make sure the judgment debtor is solvent?

Mr. Kobrick. I suppose it comes down to who is the better stakeholder, and I take it since the money in theory is money which was paid out of the Treasury in the first instance years earlier, and it is now certain that it was never owing at all, not that it was never owing at all, but that it was really an overpayment in a sense, there is a great deal of good sense in insisting that the money be collected first and litigation follow, and there is nothing in the due process clause that I see that raises any problem at all. Unless the court has some further questions—

The Court. No. I have been very much helped by the argument on both sides. I think it has been a first rate argument.

[Adjourned.]

We, Emilie Burford Murray and William H. Matheson, official reporters of the United States District Court, do hereby certify that the foregoing transcript from [typewritten] pages 1 to 128, inclusive [printed pages 18 to 101], constitutes to the best of our skill and ability a true and accurate transcription of our shorthand notes taken in the aforesaid action.

EMILIE BURFORD MURRAY,

WILLIAM H. MATHESON,

*Official Reporters United States District Court.*



AFFIDAVIT OF COLONEL MAURICE HIRSCH,  
[Filed January 9, 1946.]

MAURICE HIRSCH, being duly sworn, deposes and says:

1. On 1 October, 1942 I was appointed as an expert consultant on the staff of the War Department Price Adjustment Board. On 2 November, 1942 I was appointed chief of the Settlements Division, War Department Price Adjustment Board. On 16 April, 1943, I was appointed a member of the War Department Price Adjustment Board. On 20 September, 1943, I was appointed vice-chairman of the War Department Price Adjustment Board and as deputy director of the Renegotiation Division, Headquarters, Army Service Forces. On 10 June, 1944, I was appointed a colonel in the Army of the United States. On 1 September, 1944, I was appointed and have since served as chairman of the War Department Price Adjustment Board and as director of the Renegotiation Division. Also, on 1 September, 1944, I was appointed, and have since served as, the War Department member on the Joint Price Adjustment Board. On the same date I was elected chairman of said Board and have since served in that capacity. On 16 February, 1945, I was appointed as the War Department member on the War Contracts Price Adjustment Board and on 23 February, 1945, I was elected chairman of said Board, and have since served in that capacity. On 11 April, 1945, the under secretary of war delegated to me the duty of issuing unilateral determinations on behalf of the War Department.

2. The statements made in this affidavit are based upon information obtained by me in my official capacity and which I believe to be true and accurate.

3. The 1942 Renegotiation Act, applicable to fiscal years ending prior to July 1, 1943, is administered by the departments named in the statute. The War, Navy and Treasury Departments and the Maritime Commission publicly issued a joint statement on March 31, 1943, setting forth the purposes, principles, policies and interpretations under the 1942 Act. On September 24, 1943, the departments formed the Joint Price Adjustment Board which

then issued a Joint Renegotiation Manual setting forth regulations governing the administration of the 1942 Act. The 1943 Renegotiation Act, applicable to fiscal years ending after June 30, 1943, is administered by the War Contracts Price Adjustment Board which was created by that statute. This statutory board has issued Renegotiation Regulations governing the administration of the 1943 Act.

4. Both the 1942 Act and the 1943 Act are applicable to contracts with the named "Departments" and to "subcontracts" as defined therein. Subsection (a) (5) (i) of the 1942 Act defines the term "subcontract" as follows:

"(5) The term 'subcontract' means

(i) "any purchase order or agreement to perform all or any part of the work, or to make or furnish any article, required for the performance of any other contract or subcontract."

Subsection (a) (5) (A) of the 1943 Act defines "subcontract" in identical terms, except that it excludes "office supplies" from such definition.

5. The agencies charged with the administration of both the 1942 and the 1943 Act have, without exception, interpreted the above-quoted definition to mean that the test of renegotiability is whether the article furnished or the work done has an ultimate "end-use" in a contract with one of the named departments, the latter generally being referred to as a "prime contract" as distinguished from a "subcontract". In other words, if the article or work eventually becomes a part of, or is used directly in the production of, items sold to a named department, the purchase order or agreement covering the sale of such article or work is subject to renegotiation. This interpretation was first issued as part of the joint statement referred to in paragraph 3 above (see J-PAB-1). The interpretation next appeared as part of the Joint Renegotiation Manual described in paragraph 3 above (see JRM 333.2), and it again appeared in the Renegotiation Regulations issued by the War Contracts Price Adjustment Board (see RR

333.2). So far as I know, the "end-use" test has been applied in every renegotiation proceeding in which the subcontract definition was material, regardless of whether such proceeding was conducted under the 1942 Act or the 1943 Act, and regardless of whether the renegotiation ended in an agreement or a unilateral determination. In the application of the subcontract definition, the renegotiation agencies have not considered as relevant whether the purchase order or agreement was entered into after the prime contract in question or prior thereto.

6. It is my understanding that the Alexander Wool Combing Company is contending that the "end-use" test as applied by the administrative agencies is erroneous and that the subcontract definition should be interpreted as applicable only to a purchase order or agreement entered into at a date subsequent in time to the formal execution of the prime contract with one of the named departments covering the final item with regard to which the work or article under the purchase order or agreement was utilized. It is my opinion that the administrative agencies should not have so interpreted the subcontract definition for the following reasons:

(a) Such an interpretation would have read into the statute a limitation not there expressed;

(b) Such an interpretation would have been directly contrary to the legislative history and Congressional interpretation of the statute;

(c) Such an interpretation would have removed from renegotiation vast quantities of war business, thereby destroying one of the principal objectives of the statute, that is, the control of war profits at all levels;

(d) Such an interpretation would have resulted in a grossly discriminatory and inequitable application of the statute;

(e) Such an interpretation would have been highly unrealistic in its failure to take into account normal business practice and wartime Government procurement;

(f) Any attempt to apply such an interpretation would have substantially impeded war production; and

(g) Finally, such an interpretation could not possibly have been administered, and would have led to a complete breakdown of the statute.

7. During the consideration by the Congress of the Revenue Act of 1943, the Senate Finance Committee and the House Ways and Means Committee held hearings in connection with certain suggested amendments to the 1942 Renegotiation Act. Both committees were familiar with the interpretation of the subcontract definition set forth in the joint statement of March 31, 1943, with the administrative application of the "end-use" test, as described above, and with the fact that the administrative agencies did not consider it relevant whether the prime contract was executed before or after the execution of the subcontract. The subcontract definition was discussed at length by the two committees in connection with a suggested amendment to the definition. However, in accordance with the recommendation of the Conference Committee of the two Houses, the Congress reenacted the subcontract definition in identical language, adding an exclusion with respect to office supplies, a change which did not affect the basic definition.

8. The practice of business in this country to purchase materials and maintain inventories in advance of receiving orders for the finished product is a matter of public knowledge. In wartime this practice received a sharp impetus because of the tremendous urgency of the war procurement program. Indeed, in many instances a serious overstocking of inventory occurred, followed by direct Government control of scarce materials. Production speed so vital in modern warfare was greatly assisted by the fact (a) that American business largely anticipated the wartime requirements of the Government, and (b) that the Government, with the cooperation of industry, initiated purchases by industry of enormous amounts of materials on the basis of letters of intent, informal commitments and even telephone calls so as to enable the prime contractor to begin production without delay. Vast quantities of war materials were produced under such arrangements prior to the formal execution of the relevant prime contracts with



the Government. For illustration, a certain mechanical device was critically needed for the war effort. Contractor A, a relatively small concern, submitted a bid to the Signal Corps and was immediately requested to proceed with the work without waiting even for a letter of intent, much less a formal contract. The job was primarily an assembly operation and involved the purchase of approximately 1080 separate parts from approximately 200 suppliers. In view of the urgency of the situation, contractor A immediately proceeded with the job and, before even a letter of intent was received, committed itself in the amount of more than \$500,000 mostly for materials and supplies purchased from A's subcontractors. If the suggested "time" test had been included in the subcontract definition, many of the sales made to prime contractors and to higher tier subcontractors would have been excluded from renegotiation. In my opinion, such result would have defeated one of the principal purposes of the statute. Congress seems clearly to have intended that excessive profits arising out of the sale of war materials should be eliminated without taking into consideration the mere level of the contracts or subcontracts from which such excessive profits were accumulated. Excessive profits retained by a subcontractor may be as costly to the Government and as destructive to morale as excessive profits retained by a prime contractor.

9. Adoption of the "time" test would have resulted in an arbitrary and unreasonable discrimination in the operation of the statute. For illustration, if prime contractor A purchased the same type of materials from comparable subcontractors B and C, and if the materials purchased by A went into the product sold by A to the Government, the Renegotiation Act should affect B and C in the same manner. If, however, the "time" test had been adopted, B might have been subject to renegotiation and C exempt from renegotiation simply because B sold his materials to A after A's prime contract was executed and C's materials were sold before that date.

10. American industry, even in normal times, in substantial measure produces for inventory. In wartime, industry frequently

anticipated Government requirements, and often purchased materials and supplies well in advance of receiving Government contracts for the war-end products. Without such practice it is certain that war production would have been seriously delayed. In my opinion, the administrative agencies were required to read the subcontract definition with that in mind as it would have been unreasonable to assume that Congress intended a definition so completely at variance with such practice.

11. The interpretation of the definition as proposed by the Alexander Wool Combing Company would have required the ascertainment of the date of sale of each separate article or service used in connection with the production of the items covered by the prime contracts and also the ascertainment of the date of the prime contract. This would have been necessary in order to determine whether such article or service was furnished before or after execution of the prime contract in question, and irrespective of how far down the line of subcontracting the particular article or service was furnished. The ascertainment would have been needed in the cases of virtually all contractors subject to renegotiation since almost all had subcontracts in varying amounts. Such a task would have imposed upon American industry so great a burden of keeping records that war production would thereby undoubtedly have been very substantially impeded.

12. The renegotiating agencies regarded as obvious that it would have been impossible to administer the Renegotiation Acts on the basis of the interpretation proposed by the Alexander Wool Combing Company. Apart from the burden imposed upon industry, any attempt to administer the statute on such a basis would have required a veritable army of Government accountants and auditors and could not have been successfully concluded. Adoption of such an interpretation would therefore inevitably have led to a complete breakdown of renegotiation.

13. Renegotiation records are replete with examples of the complexities which would have been encountered if the tracing of each subcontract and prime contract, as described above, had been attempted. For illustration, the large chemical companies of the

United States were heavy suppliers of war materials. One of the leaders in this industry has a product line comprised of some 5,000 separate items. A large part of its sales during the war years was subject to renegotiation. It was, however, primarily a producer for inventory without regard to orders received from month to month, and deliveries were ordinarily made from stock. The actual number of invoices billed each month ran into the thousands and a tremendous number of monthly subcontract purchase orders were given out. Products purchased from subcontractors included many materials at various stages of chemical processing, some of which had been handled by a number of subcontractors before being received by the subcontractors in question. From the nature of the business, and the form of record keeping in this industry, it would have been impossible to identify the dates of the subcontract sales in relation to the dates of the relevant prime contracts.

14. For further illustration, companies specializing in the manufacture of engines for tanks, airplanes, and ships comprise a large segment of the wartime industry. The majority of such companies held both prime contracts and subcontracts. One of the largest companies, which can be regarded as typical of the group, is primarily an assembler in that it purchases the most important elements that enter into the final item and, after performing some machine work, constructs the engine. Among the parts purchased are nuts and bolts, some bought directly and some through jobbers, bearings and bushings of many types also purchased both directly and indirectly, crank cases and crank case forgings, cylinder heads, gears, and various other items. The parts purchased represent, in many instances, an advanced stage of fabrication and often have been processed by several subcontractors in turn. Parts such as nuts, bolts, screws, bushings and bearings are frequently standard items. Their purchase by the assembler is dictated in large part by his running inventory requirements plus his anticipation of future production requirements, rather than by specific prime contracts on hand. The same impossibility of tracing subcontract items applies here as in the illustration previously referred to.

15. The following detailed examples, in which the companies are respectively designated by letters rather than by names, are illustrative of actual situations:

(a) Company A had a large number of prime contracts for the production of tanks. Fabrication of the tank treads used in the tanks involved several steps. Company D bought steel for use in the tank tread from a number of steel companies. Company D processed the steel into a form of tubing and sold the tubing to Company C. Company C utilized the tubing in fabricating the frame for the tank tread. Company C also used certain "end connectors" which were purchased from Company N. Company N manufactured the connectors from forgings produced by Company P which purchased its steel requirements from the steel companies. Company C delivered the metal tread to Company B, a large rubber company, which applied rubber to the tread frame and then sold the completed tread to Company A. Company A installed the tread on the tank. Company A likewise purchased the requisite tank armor. Company H, a steel manufacturer, produced the raw sheet steel and sold it to Company G. Company G cut the steel, gave it a heat treatment for hardening and sold it to Company A which installed it on the tank. The tank treads and armor were, of course, only two of a large number of items purchased by Company A as necessary in the performance of Company A's prime contracts for tanks. After all such purchases had been made, any additional fabrication finished, and installation and assemblies completed, the tank was then delivered to the War Department under one of the numerous then current contracts held by Company A.

(b) Company I had a large number of prime contracts for the production of optical instruments. Company M produced the requisite raw optical glass. Company M sold the raw glass to Company L which had a subcontract for pressing the glass. Company L subcontracted a part of the



pressing work to Company K. Company L then sold the pressed glass to Company J which ground the glass to certain lens specifications and delivered the lenses to Company I; Company I installed the lenses in the instruments which were then delivered by Company I to the Government.

(c) Company Q, Company R and Company S each had a large number of prime contracts for the production of half-tracks. These are motor vehicles which have front wheels and endless track driving mechanisms. Each of these companies produced the half-track chassis but only Company Q produced the engines. Company Q purchased the cylinder blocks used in the engines from Company T. Company T purchased various types of metals from steel mills and other metal producers for the manufacture of the cylinder blocks. Company Q, after incorporating the cylinder blocks, and otherwise completing the engines, sold some of the engines to Company R and Company S and installed the remaining engines in the chassis manufactured by Company Q.

16. In none of the examples given would it have been possible to trace the subcontract items in order to determine the relative timing of the subcontracts and the prime contracts. In this respect, the foregoing examples are typical of the complexities which would have made the "time" test impossible of administration. In fact, the illustrations are very much over-simplified. In the first place, in each of the cases referred to above, many other items of materials or service were utilized in addition to the subcontracted items specifically described, and each such additional item would have involved comparable difficulties in any attempt to ascertain the relative contract and subcontract dates. In the second place, it has been assumed in the illustrations that the prime contract or contracts in question were not amended or modified during performance. Actually, many thousands of prime contracts were amended during performance by change orders and supplemental agreements. Some of these merely changed details of construction of the article in question, but many of them re-

quired changes of materials, component parts and other substantial deviations from the specifications of the basic contract. Others changed the basic contract terms with respect to price, time of delivery or quantity of articles to be furnished. For illustration, one of the contracts between Company X and the Army Air Forces provided for the furnishing of 3,000 airplane engines. Performance of this contract extended over a period of approximately 5 years. During this time, there were 293 change orders and supplemental agreements executed with respect to the basic contract. One of the contracts between Company Y and the Army Air Forces provided for the furnishing of 1884 airplane engines. Performance of this contract extended over a period of approximately 17 months. During this period there were 465 change orders and supplemental agreements. A tremendous number of other prime contracts were similarly modified in varying degrees by such change orders and agreements. If the renegotiating agencies had attempted to apply the "time" test as part of the subcontract definition, it would have been necessary (a) to determine whether each change order or supplemental agreement constituted a new prime contract; (b) to determine whether the subcontracted article or service was furnished under the original prime contract or under the new contract evidenced by the change order or supplemental agreement; and (c) to ascertain the relative dates of execution of the numerous new contracts and the subcontracts under which the article or service was furnished under each such new contract. The mere statement of the problem demonstrates the impossibility of administration of the "time" test.

17. Out of more than 94,000 initial assignments in renegotiation, over 22,200, as of 30 November, 1945, had been closed by agreements providing for the refund of excessive profits, and over 850 had resulted in unilateral determinations of excessive profits. The remaining assignments resulted in cancellations or clearances or are still outstanding. The subcontract definition has been material in the great majority of renegotiations, and in all cases the renegotiating agencies have utilized the "end-use" test and have considered that the relative times of execution of the subcontract

and prime contract were immaterial. I have not heard of any renegotiation, other than those of the Alexander Wool Combing Company and one other contractor, in which it was contended that the "time" test interpretation should be applied.

MAURICE HIRSCH,

*Colonel, General Staff Corps.*

Sworn to and subscribed before me this twenty-ninth day of December, 1945.

BERTIE M. POSTON,

[SEAL]

*Notary Public, in and for  
Arlington Co., Virginia.*

My commission expires April 15, 1947.

AFFIDAVIT OF MAJOR RALPH G. LUCAS.

[Filed January 9, 1946.]

RALPH G. LUCAS, being first duly sworn, deposes and says:

1. I am a major in the Army of the United States. Since December, 1942, I have been connected with the administration of the Renegotiation Act. I am now chief of a staff panel of the War Department Price Adjustment Board, hearing cases assigned to the Board as impasse from the field or headquarters offices of the Quartermaster Corps, Ordnance Department, and other technical services of the War Department. As a member of the Staff Panel Section of the War Department Price Adjustment Board, I participated in statutory renegotiation of the Alexander Wool Combing Company (hereafter called Alexander) with respect to excessive profits realized by that company on business subject to the Renegotiation Act during its fiscal years ended 30 June, 1942, and 30 June, 1943.

2. The statements made in this affidavit are based upon information obtained by me in my official capacity, which I believe to be true and accurate.

3. In a letter dated 23 February, 1943 the War Department asked Alexander for information which would facilitate assign-

ment of the company for renegotiation. A true copy of that letter is attached hereto, marked Exhibit A, and made a part hereof.

4. On 1 March, 1943 Alexander replied, stating in part,

"We estimate that the supply subcontracts of this company total \$3,119,064.60 in estimated value and were principally used in later manufacture of goods for the Philadelphia Quartermaster Corps (75%) and also some for the U. S. Navy (25%).

"The amount of money represented is the estimated value of the goods we handled, but the goods are owned entirely by merchants that have us perform a service on them.

"We operate a commission wool scouring business and also a commission wool combing business and do not own any of the materials we process, but simply perform a service.

"The foregoing information is based on general estimates only. Its purpose is to indicate to you, our view as to how this company should be assigned for renegotiation under section 403 of Public Law No. 528 as amended should such renegotiation be required."

A true copy of that letter is attached hereto, marked Exhibit B, and made a part hereof.

5. Thereafter renegotiation proceedings were had between Alexander and representatives of the War Department. Conferences were held in Boston between representatives of Alexander and the Boston Price Adjustment Section of the Quartermaster Corps. No agreement was reached. Further conferences were held in Washington, D. C., first between representatives of Alexander and the Quartermaster Corps, and later between representatives of Alexander and the War Department Price Adjustment Board.

6. It is the practice of the Government to request the contractor or subcontractor to submit its own figures as to the portion of its business which it considers to be subject to renegotiation. Alex-



ander informed the Government that its records did not disclose the exact end use of each lot of wool which it combed and scoured on commission but stated that a substantial portion of such wool was in fact ultimately used in the performance of prime contracts with "Departments".

Alexander reported to the Government the amounts received by it for work done for its customers, American Woolen Company, Nichols & Company, Inc., Alfred Fison, and Lorraine Manufacturing Company, and informed the Government that American Woolen Company had stated that 100 per cent of American Woolen's contracts were contracts within the Renegotiation Act; that Nichols & Company had stated, on the basis of information received from its customers, that approximately 47.8 per cent of the wool sold by Nichols & Company in 1942 was used in the performance of renegotiable contracts and 61.18 per cent of the wool sold in 1943 was so used; that Lorraine reported 100 per cent, and Alfred Fison, 19.45 per cent. Alexander contended that these figures should be reduced by about 11 per cent as an allowance for estimated waste incurred in subsequent manufacture by purchasers of its products. This latter contention was not accepted by the Government. The remaining information submitted by Alexander in this connection was accepted as accurate.

7. Alexander informed the Government that it was organized in June, 1941, with an original invested capital of \$15,000; that some of the profits were later invested in additional machinery; that it commenced operations late in September or early in October, 1941; and that until November, 1941, receipts were negligible.

8. All factual material submitted by Alexander was accepted as correct, including its representations as to the percentage and amount of renegotiable business; the costs allocable to that business (except that certain salary payments to Mr. Albert I. Alexander, president and treasurer of the corporation—who, together with his immediate family, own 50 per cent of the stock of the corporation—were disallowed in part) and the profits realized from that business. Alexander also represented that as of 28

April, 1942, it had received payment for all work performed before that time and had no outstanding accounts receivable on that date. This representation was also accepted as accurate and, accordingly, only profits realized on work done by Alexander on and after 28 April, 1942, were considered.

9. Under date of 13 July, 1944, Alexander rejected the Board's proposal for elimination of excessive profits. On 18 July, 1944, the Board advised the company as follows:

"This office will forward its reports to the representative of the Under Secretary of War for such further action as may be deemed appropriate."

Thereafter, Alexander made no request for any further hearing and submitted no further evidence or argument. On 6 September, 1944, the under secretary of war made formal determinations as to the amount of excessive profits for each of the fiscal years ended 30 June, 1942 and 30 June, 1943.

10. During the course of the renegotiation proceedings all factual data and argument submitted by Alexander were given careful consideration. In the meetings with Alexander, all facts and factors which were considered in arriving at the conclusion (with the exception of information as to the business of other contractors) were disclosed to and reviewed with Alexander. There is, of course, available to representatives of the Government information as to the business of other wool combers. Since such information is submitted in confidence by each contractor in connection with its own renegotiation proceedings, it is the fixed policy of the Government to respect that confidence and refrain from disclosing to one contractor information as to the business of other contractors. In accordance with that policy, the Government did not disclose to Alexander any information submitted by other contractors as to their own business. No other request of Alexander relating to procedure was denied by the War Department Price Adjustment Board or the under secretary of war.

RALPH G. LUCAS,

Major A.U.S.

Subscribed and sworn to before me this seventeenth day of  
December, 1945.

JOHN A. SULLIVAN,  
Major, J.A.G.D.

EXHIBIT A.

Q  
SPPDB

Budget Bureau No. 49-R019-42  
Approval Expires 3-31-43

War Department  
Office of the Under Secretary Washington, D. C.  
Price Adjustment Board

February 23, 1943

Alexander Wool Combing Company 95 Bridge Street, Lowell,  
Massachusetts

Gentlemen:

Pursuant to the provisions of Section 403 of Sixth Supplemental National Defense Appropriation Act of 1942, as amended, Price Adjustment Boards have been established by the War Department, the Navy Department, the Treasury Department, and the Maritime Commission. The function of these Boards is to conduct renegotiation proceedings with individuals or corporations who are parties to contracts with the said Departments and Commission, or are performing subcontracts thereunder. The objective of such proceedings is to lead to a clearance of the companies under the Section of the Act above mentioned.

It is the general policy of the Boards that the renegotiation proceedings be conducted by the Department or Service having the predominant interest in the business of the respective companies. In the case of companies having one or more subsidiaries, renegotiations are usually conducted on a consolidated basis by which the war contracts of both parent and subsidiary companies are considered at the same time. These policies are designed to minimize inconvenience to the contracting companies as well as to promote an efficient procedure by the Boards.

In order that your company and its affiliates, if any, may be

assigned for renegotiation to the proper Department or Service with the minimum of inconvenience to all concerned, we will be glad to receive any information which you may care to submit bearing upon the matter. Such information should cover the following subjects:

a. Your estimate of the total dollar amount of the direct (prime) contracts which your company has with (1) the War Department, (2) the Navy Department, (3) the Treasury Department, (4) the Maritime Commission. With respect to your contracts with the War Department, you should indicate how the same are divided between the several Services of Supply and the Army Air Forces.

b. Your estimate of the dollar amount of the subcontracts which you are performing. This information should also be subdivided between Departments and the Army Services as requested in paragraph (a) above. In the event that it is not readily possible to divide the subcontracts between the Departments and Services, a statement by you of the principal products furnished under such subcontracts will be helpful for the present purposes.

c. The dollar amount of the expansions of your industrial facilities (plant or equipment) which have been financed by Government agencies. These should include facilities fully or partially completed and indication should be given as to the Department of Service, if any, sponsoring same.

d. A statement as to whether your company is the parent or subsidiary of another company and the percentage of ownership. In case your company has such affiliates, the information outlined in this letter should be submitted by or for each of them. This is proposed so that, if deemed desirable, the companies may be assigned for renegotiation simultaneously to the same Department or Service, and that renegotiation proceedings may be conducted on a consolidated basis.

We inclose for your convenience a suggested outline of reply. It is requested that such reply be forwarded to us in triplicate and that a separate reply be made by or for each affiliated company.

The difficulty of giving promptly an exact statement of the



matters above mentioned is recognized. Accordingly, it is to be understood that a general estimate with respect to the amounts of contracts and subcontracts will suffice for the immediate purpose. Such information will in any case be received without prejudice to you.

The assignment of your company will be deferred for fifteen days following the date of this letter in order that you may have an opportunity to submit the information outlined above.

Yours very truly,

HARLEY C. STEVENS

Major, A.U.S. Executive Secretary

~~The contracts and subcontracts as to which advice is requested are those contracts held during your 1942 fiscal year, excepting those on which final payment had been made prior to April 28, 1942.~~

Price Adjustment Board Room 3D 581 Pentagon Building  
Arlington, Va.

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EXHIBIT B.

Alexander Wool Combing Company  
95 Bridge Street - Lowell, Massachusetts

Commission Wool Combers

Commission Wool Scourers

March 1, 1943

Assignment Section Price Adjustment Board War Department  
Room 3D-614 Pentagon Bldg. Arlington, Va.

Gentlemen:

In reply to your inquiry of February 23, 1943, we would advise as follows:—

We estimate that the supply sub contracts of this company total \$3,119,064.60 in estimated value and were principally used in later manufacture of good for the Philadelphia Quartermaster's Corp (75%) and also some for the U. S. Navy (25%).

The amount of money represented is the estimated value of the

goods we handled, but the goods are owned entirely by merchants that have us perform a service on them.

We operate a commission wool scouring business and also a commission wool combing business and do not own any of the materials we process, but simply perform a service.

We have never been financed by the government in any way.

The corporate relations of this company are entirely independent and we are not related in any way to any other party. We are set up under the laws of Massachusetts as a separate and independent corporation.

Our fiscal year ends on the 30th of June.

The foregoing information is based on general estimates only. Its purpose is to indicate to you, our view as to how this company should be assigned for renegotiation under section 403 of Public law No. 528 as amended should such renegotiation be required.

Very truly yours,

ALEXANDER WOOL COMBING COMPANY  
ALBERT I. ALEXANDER, Pres. & Treas.

AIA:c

### AFFIDAVIT OF ROBERT P. PATTERSON.

DISTRICT OF COLUMBIA, SS:

Robert P. Patterson, being duly sworn, deposes and says:

1. I am under secretary of war of the United States and have held that office, which was created by the Act of December 16, 1940, 54 Stat. 1224, since December 19, 1940. From July 30, 1940 to December 19, 1940 I was the assistant secretary of war.

2. By authority of various statutes and by various delegations of authority from the secretary of war, I am, and have been both as under secretary and as the assistant secretary of war, charged with the supervision of the procurement of all military supplies and of other business of the War Department and the Army pertaining to production and procurement.

3. The statements made in this affidavit are based upon information acquired by me in my official capacity and which I believe to be true and accurate.

## PRELIMINARY STATEMENT.

4. Wartime procurement for the military establishment differs radically from procurement in times of peace. Speed in production at once becomes all-important. Industry is called upon to produce an entire complex of new products, constantly changing in design and purpose. Quantities of both old and new products, far beyond those previously manufactured, are suddenly demanded, and in the shortest possible time. For the production of these needed items, existing plants, machinery and equipment have to be converted from producing peacetime civilian goods to meet the different and expanded needs of the armed forces. Even the marginal producers have to be used in order to meet these needs. In addition, hundreds of new plants, new machinery and new equipment have to be constructed, installed, and put to work. The nation's manpower has to be reallocated, almost overnight, to adjust to the gaps caused by the transfer of millions from production to the armed forces, and to the springing up of new industries and new areas of production. Enormous dislocations in transportation, and in the supply of raw materials have to be ironed out.

5. The necessary result of this combination of circumstances is that the war procuring agencies cannot use normal methods of procurement. The pressing need for speed requires the abandonment of drawnout negotiation and the careful surveys of all relevant factors which sound purchasing would otherwise require. Competition necessarily wanes and no longer offers an adequate guide to the prices which should be paid. Above all, the forecasting of costs of production becomes, in large measure, a matter of informed guessing rather than of real cost analysis. This is true in the case of new products, new plants, and new producers; it is likewise true, though perhaps in lesser degree, wherever the quantities to be manufactured are sharply increased over pre-war amounts. Accordingly, advance prices quoted in good faith by manufacturers in a large number of cases have little relation to costs actually experienced in the course of production. Furthermore, many manufacturers feel unable to quote firm prices without

including reserves to cover many contingencies the occurrence of which might skyrocket their costs, and so overturn all their estimates.

6. These were the conditions of wartime procurement, after December 7, 1941, and the War Department had to force its procurement activities into their mold. Efforts were made, of course, to develop contractual devices which would minimize the paramount difficulty in estimating production costs. The cost-plus-fixed-fee contract was used where unavoidable, but this form has the disadvantage of removing financial incentives to efficiency and of imposing a heavy burden of auditing upon the Government and the contractor. Escalator clauses, permitting prices to be adjusted according to fluctuations in indices of labor and material costs, were also used but proved unworkable. Letters of intent, under which manufacture was commenced prior to the negotiation of a formal contract, helped to speed production, but could not, of course, solve the ultimate problem of decreasing costs and preventing excessive profits.

7. Shortly after the declarations of war, both the legislative and the executive branches of the Government realized that excessive wartime profits were certain to accrue unless counter measures were taken. The evil effect of such wartime excessive profit on the morale of the fighting forces, and the civilian population, as well as the unnecessary financial burden upon the Government, could not be ignored. The example of the last war was still fresh. Many war contractors realized the dangers and inequities resulting from such excessive profit, and some of them made refunds of excessive profits or voluntarily reduced their prices. In the spring of 1942, the War Department developed cost analysis units to check, so far as practicable, on production costs, and set up a price adjustment board to negotiate with contractors for voluntary price reductions and refunds of past payments. Tentative policies as to what profits were excessive were established and meetings with contractors had. At the same time, there came into use contract clauses providing for the renegotiation or redetermination of contract prices after an initial period of production had



laid a basis for the proper estimation of costs. We hoped that these means would keep incentives to efficiency alive and at the same time would tend to eliminate undue profits such as were then coming to light.

8. The Congress apparently felt, however, that these contractual measures, resting as they did upon the voluntary cooperation of a relatively small number of war contractors, did not provide enough certainty that excessive profits would be eliminated. The Vinson-Trammel Act, limiting profits on aircraft and ship construction, had been repealed in 1940, but an effort was made to revive it. In March, 1942, the War Department and the War Production Board opposed such legislation on the ground that a flat percentage profit limitation would impede production and would be unfair to many contractors and too generous to others. After the Case amendment imposing such a flat percentage limitation on profits from war contracts had been adopted by the House of Representatives late in March, 1942, the armed services and the War Production Board offered a substitute proposal giving statutory authority to the process of voluntary renegotiation which had been developing. Congress adopted the principle of renegotiation with which the armed services were in accord (rather than the principle of a flat percentage limitation of profits), and it also endowed the procuring agencies with power to determine excessive profits when no bilateral agreement could be reached with the contractor. I believe that this addition by the Congress of the power of unilateral action was a wise and a necessary one, and that without it renegotiation would not have accomplished anything like the results that have been achieved.

9. The purpose of this affidavit is to present the facts showing in greater detail, (a) the nature and extent of the procurement problems of the Army after the declaration of war, (b) the need for renegotiation and limitation of profits of war contractors and the steps which had been taken in that direction prior to the enactment of the renegotiation statute, and (c) what statutory renegotiation has accomplished.

THE ARMY'S PROCUREMENT PROBLEMS SUBSEQUENT TO THE  
DECLARATION OF WAR.

10. Immediately after the attack on Pearl Harbor, on December 7, 1941, the War Department's procurement program was sharply accelerated to meet the new requirements imposed upon the country and the Army by the sudden involvement of the United States in the war. The defense procurement program had been large, but the effort was minor in comparison with that necessitated by the demands of active warfare. Supplies, equipment, housing, ammunition, and weapons had to be secured, in the least possible time, for our rapidly expanding armed forces, and for the anticipated needs of a war to be fought on two sides of the globe. In addition, increased supplies for the nations with which we were allied had to be produced with the greatest possible speed. All phases of procurement were stepped up: production of the weapons of war, such as guns, planes, tanks; construction and equipping of camps; procurement of equipment and supplies for the troops; construction of plant facilities; production of the means of communication and transportation.

11. The extent of the problem facing the procurement agencies can be judged from the goals set by the president in his message to Congress of January 6, 1942. The president stated:

I have just sent a letter of directive to the appropriate departments and agencies of our government ordering that immediate steps be taken:

First to increase our production rate of airplanes so rapidly that in this year 1942 we shall produce 60,000 planes, 10,000 by the way, more than the goal that we set a year and a half ago. This includes 45,000 combat planes, bombers, dive bombers, pursuit planes. The rate of increase will be maintained, continued, so that next year, 1943, we shall produce 125,000 planes, including 100,000 combat planes.

Secondly, to increase our production rate of tanks so rapidly that in this year, 1942, we shall produce 45,000 tanks, and

to continue that increase so that next year, 1943, we shall produce 75,000 tanks.

Third, to increase our production rate of anti-aircraft guns so rapidly that in this year, 1942, we shall produce 20,000 of them, and to continue that increase so that next year, 1943, we shall produce 35,000 anti-aircraft guns.

And fourth, to increase our production rate of merchant ships so rapidly that in this year, 1942, we shall build 8,000,000 deadweight tons, as compared with a 1941 completed production of 1,100,000. And finally, we shall continue that increase so that next year, 1943, we shall build 10,000,000 tons of shipping.

Illustrative of the tremendous undertaking facing both American industry and the procurement agencies is the fact that the total number of planes (military, commercial, and private) produced from 1903 to 1940 was some 33½ per cent less than the number scheduled for the year 1942 alone, and that procurement of planes for the Army during 1942 was over 250 per cent greater than in 1941. For the fiscal year ending June 30, 1942, the money appropriated for War Department procurement and construction was more than six times the amount appropriated in the fiscal year 1941. One-third of the total was appropriated by the Congress in the first half of the fiscal year 1942, before the United States had been attacked; after Pearl Harbor, the Congress tripled the new procurement funds made available earlier in the fiscal year.

12. To fulfil the requirements of this expanded war program, a vast number of contracts had to be made, as quickly as possible, for supplies, weapons, and munitions of all kinds. Attached as Exhibit A is a chart (based on information furnished by the War Production Board) showing the number and dollar value of contracts for all types of war materials entered into each month from July, 1941 through June, 1942 by the various procuring agencies. The tremendous increase which occurred in January, 1942 and continued through the remaining months of that fiscal year is clearly shown by this chart. In November, 1941, the total dollar value

of such contracts was \$1,506,000,000; in December it jumped to \$3,131,000,000; and in January, 1942 to \$9,456,000,000; in the remaining months of the fiscal year it never fell below \$4,800,000,000. The chart, it should be noted, understates both the total number of contracts and their total dollar value, since it excludes (1) contracts with a value of less than \$50,000 (of which there were a vast number), (2) contracts for subsistence, and (3) construction contracts. An idea of the comparison between the total number of contracts entered into by the War Department prior to Pearl Harbor and thereafter can be gained from the fact that the number of contracts for the fiscal year ending June 30, 1941, was 667,364, while that for the four months of July, August, September, and October, 1942 alone was 1,408,141. All these figures concern only prime contracts, but the vast stimulating effect of this expanded volume of prime contracts upon subcontracting of all tiers is readily apparent. On December 31, 1941, War Department obligations for supplies and new capital facilities amounted to more than 9 billion dollars, but on June 30, 1942, they amounted to nearly 43 billion dollars. War Department expenditures for delivered supplies were nearly 4 billions on December 31, and were more than 13 billions on June 30. In the last six months of the fiscal year ending June 30, 1942, War Department contractual activity and the delivery of supplies were four times greater than in the first six months. Some conception of the vast scope of the procurement activity of the armed services after the attack on Pearl Harbor can be gained from the fact that the total expenditures of the War and Navy Departments for the one fiscal year ending June 30, 1942 (\$22,905,000,000) considerably exceeded the total military and naval expenditures of the Government from 1789 through the end of World War I.

13. To meet these accelerated demands, the armed forces had to call, in largest measure, upon private industry which, prior to December 7, 1941, was devoting only 25 per cent of its total production to defense work, and of this amount, by far the largest proportion resulted from the use of existing idle capacity and the establishment of new facilities rather than from the conversion of



existing facilities geared to civilian production. Little stoppage of civilian production had occurred prior to December 1, 1941. If the imperative needs of the armament program were to be satisfied, wholesale conversion of existing production facilities to a war economy would have to occur. By the end of 1942, the proportion of manufacturing industry devoted to war production amounted to upwards of 45 per cent, and presently this percentage is estimated at 60 per cent. Some of this increase is, of course, attributable to the continued construction and use of new facilities, but the greater part of it has come from conversion of existing facilities since December, 1941.

14. The armed forces were thus forced to grapple with major difficulties stemming from (a) the greatly increased demands for supplies of all types, (b) the accelerated program requiring immediate production, and (c) the urgent and rapid conversion of the great mass of American industry to war work and the large-scale use of new facilities. Other acute problems were caused by (d) the demand for new products not previously manufactured, and by the constant modification of specifications to reflect improvements in design or changing needs, and (e) by the current uncertainty in the amounts of material to be procured, and the grave difficulties in the supply and cost of labor and material which were daily arising at that time.

(a) The greatly increased demand for supplies made the accurate forecasting of costs very difficult. Starting costs were bound to be higher than those incurred after mass production had begun; but the extent to which quantity production would bring a sharp drop in costs could not be estimated either by the Government or by contractors, and the latter were naturally very cautious in prophesying about their future costs. This was frequently true in the case of standard articles previously manufactured in small quantities and was uniformly true in the case of new products.

(b) The urgent need for placing orders and starting production as soon as possible placed the importance of speed far above thorough analysis or careful negotiations. Time was of the essence, and the Government personnel entrusted with negotiation

and procurement were, of necessity, too few and too overburdened to follow the normal procedures of careful procurement. There was simply no time to collate and check the cost information which in less abnormal times would be required; and, of course, such cost information pertinent to wartime production was frequently nowhere obtainable.

(c) The conversion of peacetime facilities to war work meant that cost data for the new production were unavailable, even for established plants. And in the hundreds of new plants producing war goods, only the roughest guess as to the costs of manufacturing which would be experienced during actual production could be made. Marginal producers, and those with no experience with the product or with the greatly increased quantities they would be called upon to produce, had to be used.

(d) War on the scale and under the conditions we are fighting calls for unceasing development, production, use, and improvement of countless new supplies and weapons. The demands of amphibious warfare, for instance, led to the development of amphibian boats and cargo carriers. The mechanization of modern warfare forced the development and rapid production of such items as tanks and motorized gun carriers as well as of the weapons employed against them: anti-tank guns and grenades, armor-piercing ammunition, self-propelled mounts, and anti-aircraft guns. The spurt and rapid changes in aircraft development are common knowledge, as is the growth of communication and detection devices. Changes in design and material also frequently resulted from shortages of previously used components. The use of steel had to be severely limited wherever a less critical material could be substituted. Motor vehicle cargo bodies, for example, were converted from steel to wood. Acute shortages of copper and brass led to other changes in accepted design. Great use was made of plastics in order to release critical metals. This activity can be partly epitomized in the summary statistic that during the fiscal year 1942 approximately 1,200 Army specifications were reviewed, and revised or approved, and about 425 specifications were completely cancelled.

(e) Material and labor shortages were acute in the spring of 1942. The consequence was that it was generally difficult, except within the widest limits, to establish accurate schedules for the production of supplies. The Army's requirements had to be drastically reduced, in the months from February to June, 1942, because of these factors, and these changes and reductions were reflected in the War Department's procurement program. An equally important consequence was the difficulty of gauging both the costs and the time of performance because of the shortages and anticipated rise in the costs of labor and materials.

15. All these factors made advance pricing a haphazard process in which the war procurement agencies could put little trust. The situation with which we were faced is well summarized in the following two statements (one by a Government agency and the other by a large war contractor) with which I am in full accord and which I believe to be an accurate description of the procurement situation as it existed after the coming of the war. The following is an excerpt from the Introduction to the Renegotiation Regulations issued by the War Contracts Price Adjustment Board:

The war program creates problems of procurement and production unprecedented in scale and complexity. War materials of all kinds are required in enormous quantities with the greatest possible speed. The munitions program expanded with such rapidity that contracting officers were hard pressed to place contracts in time to meet the accelerated requirements. In order to avoid delay, they had to make contracts without adequate data. Obtaining the material was the first issue. Many contractors were asked to produce articles which had never been produced before and which were subject to frequent change. Others were asked to produce articles which were new to them. Still others, who had produced articles in small quantities, were asked to produce them in amounts far beyond their previous experience. Quantities needed, the rates of delivery and specifications had often to be revised in the light of experience and the demands

of war. Shortages of material, priorities, and allocations increased the uncertainty of production.

Besides these circumstances, contractors and contracting officers were frequently unable to make an accurate forecast of costs on which to base prices. During the period of transition, costs were certain to be high. New facilities had to be obtained, new personnel employed and trained to new methods and new sources of supply developed. How long this would take was itself uncertain. After the contractor got into production, greater efficiency, improved methods, and increased volume could be expected to reduce costs sharply.

The following are excerpts from a report by the General Motors Corporation, in September, 1943, to the War Department Price Adjustment Board:

With the advent of the war-production program, the automatic check on pricing policy which had been furnished by competition during peacetime could no longer be relied upon. The Corporation was obliged to undertake the manufacture of many products which were entirely foreign to its own past operations. In many instances, these products had not been produced by any manufacturers in the volume contemplated by the war program. As a result, there was no ready-made yardstick against which the Corporation could measure proposed prices, and it became necessary to rely largely upon the judgment of the several general managers of the operating divisions and the Government contracting officers, as well as whatever limited experience might be available from other producers, as to the reasonableness of the cost estimates and prices submitted. In certain cases, the only practical solution of the pricing problem has been to insert clauses into contracts providing that prices would be reviewed as soon as representative cost experience had been obtained as a result of volume production.

Under these circumstances, it has been impossible to pre-



dict with any degree of certainty what the operating results of particular contracts might ultimately be. It therefore became imperative for the Corporation to establish as soon as possible a basic pricing policy which would take into account these unusual conditions and insure that proper and effective pricing control would be obtained. In establishing this policy, the primary considerations were two-fold. First, it was recognized that in producing war material, the checks of normal competition had been removed, and that the peacetime conception of desirable profit margins as previously described, had to be modified. Second, it was considered essential to maintain, as far as possible, the Corporation's normal method of doing business on a decentralized basis, with primary responsibility for contracting, pricing and production resting upon the divisional general managers, subject to the over-all general policies of the Corporation.

The policy of taking contracts on a fixed-price basis whenever practicable was adopted (despite the increased risk) because of the greater incentive to efficient operation afforded by this type of contract as compared with the cost-plus-fixed-fee type. However, it was recognized that the divisions were undertaking the production of war materials which were not only new to the Corporation, but had not been manufactured by anyone on a "mass-production" basis. Therefore, there was always a possibility that initial cost estimates on certain contracts, even though they appeared reasonable to the divisional general managers and to the Government contracting officers at the time the estimates were prepared, might turn out to be higher than actual costs of production as volume increased, when designs were changed, and as manufacturing experience was obtained.

16. A graphic illustration of the way in which all the factors of uncertainty listed above combined to make the advance estimation of costs extremely difficult in 1941 and 1942 is furnished by the experience of the General Motors Corporation. That company is one of the largest peacetime manufacturers of automotive

products, its accounting and auditing procedures are superior, and its ability to forecast the costs of manufacture of automotive products would far outrun that of most other producers. Nevertheless, as the company itself fully realized (see paragraph 15 above), even it was in no position to estimate its costs with any acceptable margin of accuracy. General Motors accepted contracts containing redetermination provisions, under which an original price based on the best available estimate of costs was established, with revisions made after the costs of a preliminary run of 1,000 units and a test run of a further 1,000 units were available. The price for the remainder of the contract was determined on the basis of the test run. The results obtained under two of these contracts were as follows:

a. Medium Tank (per unit):

Original price (middle of 1941) .....	\$67,401
	Estimated redetermined value
Preliminary run (March, 1942–December, 1942), 1,000 units (including preproduction expenses) ..	\$50,947
Test run (December, 1942–February, 1943), 1,000 units .....	39,079
Remainder (February, 1943–August, 1943), 1,053 units .....	39,285

b. Light tank (per unit):

Original price (set during 1941) .....	\$45,000
	Estimated redetermined value
Preliminary run (April, 1942–October, 1942), 1,000 units .....	\$34,625.99
Test run (October, 1942–December, 1942), 1,000 units .....	26,972.96
Remainder (December, 1942–February, 1943), 1,266 units .....	28,347.09
2nd Preliminary run (Feb., 1943–June, 1943), 1,000 units .....	24,658.65

c. The following table illustrates the sharp decrease in costs following a sharp rise in quantity of production, and the gaining of manufacturing experience. The figures represent revisions of General Motors Corporation's price for the .50 cal. heavy barrel machine gun:

	Units	Price
Original price (Aug., 1941-Dec., 1941) . . . . .	1,308	\$868.07
1st revision (Jan., 1942-Mar., 1942) . . . . .	2,830	632.55
2nd revision (Apr., 1942-May, 1942) . . . . .	3,247	532.00
3rd revision (May, 1942-Sept., 1942) . . . . .	14,717	413.60
10th revision (June, 1943-Aug., 1943) . . . . .	3,500	300.59

17. Faced with these difficulties of estimating production costs and also with the pressing need for speed in procurement, the War Department naturally chose to emphasize, after December 7, 1941, the speedy placing of a mass of contracts. Pressure to obtain supplies was already great before the attack on Pearl Harbor, but thereafter it was made even clearer to contracting officers that they were expected to place the increasing load of orders assigned to them with the least possible delay. The war would not rest to allow proper negotiation, and the War Department made it clear that the primary goal was speed in obtaining the necessary equipment and supplies. Illustrative is P. & C. General Directive No. 8,<sup>1</sup> issued January 14, 1942 (attached hereto as Exhibit B), which stated that "price is a secondary consideration as compared with speed and efficient production"; and "speed in placing orders now authorized is important, but speed of production as a whole during the next 18 months is of even greater importance. . . . War calls for the same boldness and imagination in procurement as it does in meeting combat conditions in the field." War Production Board Directive No. 2, March 3, 1942,

<sup>1</sup> P. & C. General Directives were issued, under my direction, by the Purchases and Contracts Branch of the Office of the under secretary of war; this branch later became the Contract Division, and the directives were entitled CD General Directives; in March, 1942, the unit became the Purchases Branch, Procurement and Distribution Division, Headquarters, Services of Supply, and the directives were entitled PB General Directives.

placed "primary emphasis . . . upon securing delivery in the time required by the war program". P. B. General Directive No. 34, dated April 9, 1942, which coordinated War Department rules concerning purchases, reiterated the WPB standards, and added that in giving effect to these policies "it is recognized that it may be necessary to purchase at other than the lowest price offered".

18. To implement this policy of speedy procurement, and at the same time to adjust, as best it could, to the conditions of wartime production, the War Department adopted several procurement devices and policies.

a. Peacetime War Department procurement, with certain exceptions, was accomplished through advertising for bids. At the beginning of the general emergency it was foreseen that this method would prove impracticable for emergency procurement, and the Act of July 2, 1940 (Public No. 703, 76th Congress) authorized contracting without advertising for national-defense purposes. This authority was widely used for the purchase of such supplies as aircraft and tanks, but in many fields it was believed that the Government could still avail itself of the safeguards of letting contracts by advertising. After the declaration of war, however, it was seen that negotiation would have to supplant advertising almost entirely. The increased need for speed in procurement, the necessity of employing even high-cost producers, the unfamiliarity of most contractors with the products or the quantities they were called upon to manufacture, and all the uncertainties of the period described above, combined to render advertising unsuitable to wartime procurement. Accordingly, on December 16, 1941, the secretary of war issued a directive broadly extending the authority to make procurements without advertising, and by directive of December 17, 1941 (P. & C. General Directive No. 81) I ordered "that the authority to place orders without advertising be utilized in all cases where that method of procurement will expedite the accomplishment of the war effort". The First War Powers Act of 1941 (approved December 18, 1941), and Executive Order No. 9001, issued December 27, 1941, con-



firmed and extended the power to make contracts by negotiation, and thereafter the use of that method became dominant in Army procurement. On March 3, 1942, War Production Board Directive No. 2 required all of our war contracts to be negotiated (unless specific authority to advertise were granted), and on March 4, 1942, this rule was made effective in the War Department by CD General Directive No. 25.

b. Speed in procurement and the utilization of all available producing facilities required decentralization of procurement, increased subcontracting, and widespread distribution of war orders.

(1) Prior to December, 1941, considerable decentralization had been effected; the limits of the dollar amounts of contracts which could be approved by echelons below the office of the under secretary of war had gradually been raised to \$500,000. On December 16, 1941, the secretary of war directed a sweeping decentralization of procurement, and on the next day I issued P. & C. General Directive No. 81, empowering the chiefs of the supply arms and services to approve contracts up to \$5,000,000, and authorizing them to decentralize still further. This directive stated that "In order to enable orders to be placed in the quickest possible time, it is desired that chiefs of supply arms and services decentralize to their field agencies the actual work of procurement and the placing of awards and contracts to the greatest extent compatible with efficiency and proper safeguarding of the public interest." (2) Subcontracting had also been fostered from the beginning of the emergency, since it was foreseen that full defense production could not otherwise be achieved. With the outbreak of the war, P. & C. General Directive No. 8, dated January 14, 1942 (Subject: "Selection of Contractors for war production"), strongly emphasized this need and required procurement officials to insist upon subcontracting: "The heavy procurement program and need for speed in production make vital the best utilization of every facility." (3) For the same reasons, the policy of the widespread distribution of defense orders was adopted. This policy was partially crystallized in War Production Board Directive No. 2, March 3, 1942, which stated "that

contracts shall be placed so as to conserve, for the more difficult war-production problems, the facilities of concerns best able, by reason of engineering, managerial, and physical resources, to handle them. Accordingly, contracts for standard or other items which involve relatively simple production problems shall be placed with concerns, normally the smaller ones, which are less able to handle the more difficult war-production problems."

c. Letters of intent were used early in the emergency to expedite production. Through use of this form of contract, the contractor could begin manufacturing the needed supplies before agreement had been reached on a definite price, or the full extent of the procurement determined. The slightly different letter contract form was authorized in May and June, 1941, for the same purpose. On December 17, 1941, there was issued at my direction, P. & C. General Directive No. 88, which ordered the more extensive use of letter contracts "in the interest of expediting procurement". On January 16, 1942, revised letter contract forms were issued, and on January 13, 1942, a letter purchase order (to replace the letter of intent) was issued and its use directed by contracting officers "where the necessity for the supplies is so urgent as to render prior negotiations in respect to price, schedule of deliveries, or other terms impracticable, or where negotiations in respect thereto have failed to result in an agreement" (P. & C. General Directive No. 5). These policies were emphasized to the contracting personnel by the various supply arms and services. For instance, the Signal Corps directed (April 20, 1942) that in no case in which time was of the essence should the selection of a satisfactory contractor be delayed to await agreement on the price; "if immediate agreement cannot be reached on the price, a letter purchase order or a letter of intent should be issued to the contractor selected, so that production can be initiated pending the negotiation of price". Pursuant to these directions, these contract forms were used in great number throughout the War Department.

19. Contractual devices were also adopted in an attempt to

overcome the insistence of contractors on covering all the contingencies of wartime production into their prices.

a. One means, of course, of eliminating the probability of excessive profits and of tying the contract price to actual costs is the cost-plus-fixed-fee form of contract. The Act of July 2, 1940, authorized the use of this form, and War Department directives of the same day permitted its use when "deemed necessary in the interest of the United States in order to accomplish or expedite the national defense program". But this form of contract has never been favored by the War Department, for the reasons that it offers no financial incentive to control or reduce costs and that it requires an inordinate amount of auditing and paper work. However, its use was found necessary in some cases. P. & C. General Directive No. 81, dated December 17, 1941, provided that "contracts will be negotiated on a cost-plus-a-fixed-fee basis only when the use of that form of contract is essential". Later directives have continued and strengthened that policy and have consistently urged the conversion of cost-plus-fixed-fee contracts to the fixed-price basis.

b. Another attempt to meet the objections of suppliers who felt that they could not quote firm prices because of anticipated rises in material and labor costs, were escalator-price adjustment clauses. On September 17, 1941, the War Department approved a price adjustment (escalator) article to be used "only in exceptional cases where the facts justify their use". (P. & C. General Directive No. 48.) It was expressly required that all contracts containing the escalator clause also include an article providing for termination of the contract for the convenience of the Government. On December 17, 1941, P. & C. General Directive No. 86 issued certain amendments, mainly concerning indirect labor and material costs, to the approved clauses. Copies of these two directives (including the escalator clauses) are attached hereto as Exhibits C and D. Escalator clauses present some of the undesirable features of cost-plus contracts. Their administration is complex, and they require extensive accounting and auditing.

These devices were not favored by the War Department, for

the reasons I have stated. By themselves, they were not satisfactory or effective methods for confining profits to reasonable levels or for decreasing production costs. Other means of attaining these ends had to be developed.

#### NEED FOR RENEGOTIATION AND PROFIT LIMITATION AND MEASURES TO THAT END.

20. At the beginning of the limited emergency in 1939, the only applicable statutory limits on profits from the sale of military or naval supplies were contained in the Vinson-Trammell Act of March 27, 1934, as amended (relating to naval vessels) and the Merchant Marine Act of 1936, as amended (relating to construction of merchant ships). The Act of April 3, 1939, extended percentage profit limitation to cover Army aircraft contracts. The percentage of profit allowed to contractors was lowered to approximately 8 per cent by the Act of June 28, 1940, but the Second Supplemental National Defense Appropriation Act, 1941, enacted September 9, 1940, provided that as to aircraft the old limitation of 12 per cent was to prevail.

21. Manufacturers of war products, particularly aircraft manufacturer, asserted that they could not take Government contracts in the face of these profit limitations. Many subcontractors were reluctant to work for them under Government prime contracts at 8 per cent or 12 per cent when they could make 15 per cent or 20 per cent working for civilian manufacturers. Moreover, many subcontractors were unwilling to take contracts which involved the necessity of keeping elaborate cost records subject to Government audit. It was therefore decided that the Vinson Act would have to be suspended, and that an excess profits tax should be levied. Accordingly, the Second Revenue Act of 1940, containing the excess profits tax, suspended the profit limitation statutes applicable to Army and Navy contracts entered into after December 31, 1939, or uncompleted on that date by contractors and subcontractors, subject to the new excess profits tax. Thereafter, until the passage of the Sixth Supplemental National Defense Appro-



priation Act of 1942, the only statutory provisions concerning war or defense contracts were those of the excess profits tax.

22. From the beginning of 1942, officials of the War Department were aware that a necessary result of the unstable purchasing conditions of war procurement would be the accumulation by many contractors and subcontractors of excessive profits which would not be siphoned off by the existing tax legislation. Publication of financial reports of war contractors for 1941 indicated the tremendously increased profits derived from the more limited defense program. The decision of the Supreme Court in *United States v. Bethlehem Steel Corporation*, 315 U.S. 289, decided in February 1942, reemphasized the extent of the profits which had been made in World War I. On March 23, 1942, the Naval Affairs Committee of the House of Representatives conducted a hearing on the defense profits of Jack & Heintz, Inc. (Hearings before the Committee on Naval Affairs, House of Representatives, 77th Cong., 2d Session, pursuant to H. Res. 162, Vol. 1), and the information divulged at that hearing on the exorbitant profits made by that concern received wide publicity. Other information of the same character was developed by the Naval Affairs and other Congressional Committees and was made available to the War Department. The War Department and at least one of the supply services (the Signal Corps) established rudimentary cost analysis units to study the manufacturing cost of Army suppliers, and preparations were made to review and check contract prices.

23. The need for eliminating excessive profits obtained from war production is as paramount as it is obvious. Excessive profits mean increased tax and war loan burdens on the public and increased pressure toward inflation. Undue profit margins are also a cushion for wasteful and costly manufacture. Perhaps most important is the destructive effect of excessive war profits upon the morale of men in the armed services and of civilian workers. The sharp reaction to war profits which occurred after World War I is eloquent testimony of the significance of this factor.

## VOLUNTARY RENEGOTIATION.

24. During the defense period, prior to December 7, 1941, there had been a certain number of voluntary refunds and price reductions by defense contractors. In June and July, 1941, War Supplies, Ltd., the Canadian Government corporation through which the United States purchases in Canada, agreed to refund to the War Department all profits over 10 per cent of cost. In October, 1941, it was found advisable to issue a directive on the taxable character of sums received by contractors but voluntarily refunded to the United States. P. & C. General Directive No. 54, October 7, 1941, stated that: "From time to time a contractor with the Government discovers that his profits are larger than he had at first estimated, and desires to refund the excess to the United States. Under these circumstances, certain contractors have hesitated lest in making the refund they subject themselves to a tax penalty, either through paying or having paid income taxes on the profits received or through being forced to pay a gift tax on any refund." But voluntary renegotiation took on much greater scope in early 1942.

25. On the same day that they appeared before the Naval Affairs Committee (March 23, 1942), officials of Jack & Heintz, Inc. met with procurement officials of the War Department for the purpose of reviewing the company's Army contracts. It was agreed that the contractor would reduce its prices on its various contracts, totaling somewhat over \$50,000,000, by an over-all amount slightly in excess of \$10,000,000. On March 28, 1942, our procurement officials met with officials of Continental Motors Corporation to review that company's aircraft contracts. After negotiations, the company voluntarily agreed to reduce its prices on existing contracts by a total of \$40,000,000. A third such meeting, on April 11, with the Sperry Corporation resulted in a voluntary reduction of about \$100,000,000.

26. Other voluntary renegotiations were effected in the first quarter of 1942. A number of contractors expressed their wil-

ingness to adjust their prices to reflect actual costs, as they developed, and to restrict their profits to proper wartime levels.

a. Prior to May, 1942, General Motors Corporation had made voluntary price reductions running into more than \$200,000,000, according to its own figures. One example follows: In a contract made in August, 1941 for 8,000 aircraft engines, the Allison Division of General Motors included contingency reserves in the unit prices but stated that if excessive profits developed during the course of performance it would be willing to grant reductions on undelivered engines. In December, 1941 and January, 1942, the War Department received information that costs were lower than anticipated. Renegotiation discussions were begun with the contractor, and on March 30, 1942, it offered to refund approximately \$20,000,000 to the Government.

b. In June, 1941, Republic Aviation Corporation undertook to manufacture 125 P-43A airplanes, over a period of some ten months, at a stated unit price. The Government's negotiators believed that the agreed price might lead to excessive profits. The contractor's representatives, though believing that the price was not too high, orally agreed that if profits in excess of 10 or 11 per cent were made, the company would either voluntarily reduce its contract price or would construct an experimental plane for the Government without cost. On December 10, 1941, the contractor informed the Government that its profit on the contract would probably exceed the stipulated amount and suggested that it furnish the experimental airplane. The War Department was not interested in the experimental airplane, and after further cost figures indicating excessive profits became available, the contractor offered an acceptable voluntary price reduction of \$1,445,370.

c. In April, 1942, information became available that Beech Aircraft Corporation was making a profit of approximately 33 per cent on its airplane contracts. On April 16th and 17th the company agreed to review the contract prices, and shortly thereafter price reduction agreements were consummated.

d. Similarly, in April, 1942, discussions were begun with Cessna

Aircraft Corporation, Bendix Aviation Corporation, and some other contractors, which resulted in price reductions.

27. In March, 1942, the War Department determined to establish formal price renegotiation machinery, and plans were drawn for a Price Adjustment Board to negotiate with contractors for reduced prices where excessive profits had been or were likely to be secured. On March 27, 1942 there was prepared in the War Department a tentative memorandum outlining the policy and procedure of the putative War Department Price Adjustment Board. The purpose of the Board, its operating policies, and method of operations were set forth, as well as a list of factors to be considered in determining the reasonableness of profits. A copy of this memorandum is attached as Exhibit E. To be noted is the similarity between the factors listed as governing profit reasonableness in this memorandum, in the joint statement by the War, Navy, and Treasury Departments and the Maritime Commission, dated March, 1943, and in the Renegotiation Act, as amended and reenacted in the Revenue Act of 1943. This memorandum of March 27th was not published nor was it issued officially, but use was made of it in voluntary renegotiations conducted by the War Department. At the meeting of March 28th with Continental Motors Corporation (see paragraph 25 above) this memorandum was read to the contractor's representatives as a preliminary and tentative statement of War Department policy on excessive profits.

28. Title XIII of the Second War Powers Act, enacted March 27, 1942, conferred upon the Government authority to inspect the plants, books, and records of war contractors. On April 10th, the president issued Executive Order 9127 ("Designating the Departments and Agencies to Inspect the Plants and Audit the Books and Records of Defense Contractors under Title XIII of the Second War Powers Act, 1942") in order "to prevent the accumulation of unreasonable profits, to avoid waste of Government funds, and to implement other measures which have been undertaken to forestall price rises and inflation". Under this order, the



cost analysis units in the War Department were expanded and strengthened, and a new basis was laid for price adjustment boards.

29. The under secretary of war, the under secretary of the Navy and the chairman of the Maritime Commission (with the approval of the chairman of the War Production Board) agreed to establish price adjustment boards within the three agencies in order to advise and assist procurement officials "in securing adjustments or refunds in instances where it is determined that costs or profits of contractors are, or may be, excessive for any reason". A copy of this memorandum is attached as Exhibit F. Plans for such a board in the War Department had been proceeding meanwhile and on April 25th, Lieutenant General Brehon Somervell, commanding general of the Services of Supply, formally established such a price adjustment board, with my approval. A copy of his memorandum is attached as Exhibit G.

30. A corollary to the establishment of these procedures for voluntary renegotiation, without specific contractual or statutory basis, was the development of contract clauses looking toward the renegotiation or redetermination of prices after partial or complete performance. The problem was submitted to a committee of representatives of the War Production Board, the War Department and the Navy Department and resulted in the preparation of two contract clauses. One, known as the "redetermination clause", was designed to permit automatic adjustment downward in price on the basis of actual cost experience during a "test run" early in the performance of the contract. The other contract provision, originally known as the "renegotiation clause", was designed to permit adjustment of the price either upward or downward in the light of actual cost experience after part performance, as soon as reasonably reliable cost estimates were feasible. These articles were promulgated for use in War Department contracts, by P. B. General Directive No. 31, dated March 13, 1942, a copy of which is attached as Exhibit H. One of the purposes of the new clauses can be gained from the opening statement of the directive that "It is essential to eliminate all delays in the production of items immediately required which result from the time required for the negotiation of fixed price contracts."

## STATUTORY PROPOSALS.

31. The Congress was, of course, also concerned with the probability that excessive profits would be made by many war contractors, despite the excess profits tax. The disclosures at committee hearings and the profit information available was thought to require legislative action. In March, 1942, a bill was introduced to establish a rigid profit limitation of 6 per cent on war contracts. On behalf of the War Department, I opposed this proposal before the Committee on Naval Affairs of the House of Representatives (March 19, 1942), and Mr. Donald Nelson opposed it on behalf of the War Production Board (March 24, 1942). (Hearings before the Committee on Naval Affairs, House of Representatives, 77th Cong., 2nd Session, on H. R. 5790, pp. 2473-2475, 2577-2578.) Mr. Nelson and I pointed out that the bill, if enacted, was likely to interfere with war production, especially by delaying the conversion of small business to war work and also by forcing the increased use of the cumbersome and wasteful cost-plus-a-fixed-fee contract. We also pointed out that a fair percentage of profit was not solely a function of the cost of performance but depended upon such factors as turnover, volume of business, amount of invested capital, financial structure, time of performance, and contribution to increased efficiency. Depending upon these factors, and particularly upon dollar volume of business, a 6 per cent profit might be far too large or far too small. Attention was also called to the impossibility, under the flat percentage system, of allowing the recoupment of losses. At the same time, I stressed to the committee that the War Department recognized its "plain duty to take every practicable step to prevent contractors from obtaining excessive and unconscionable profits", and I described the cost analysis and price adjustment projects which were then being formulated (see pars. 27-29 above), and the price redetermination and revision clauses which had been authorized (see par. 30 above). This profit limitation bill, to which I expressed the War Department's opposition, was not acted upon by the House of Representatives.

32. On March 28, 1942, Congressman Case offered on the floor of the House of Representatives two profit-limitation amendments to the Sixth Supplemental National Defense Appropriation Bill. His first proposal was that no final payment on a war contract be made by the Government "until the contractor shall have filed with the procuring agency a certificate of costs and an agreement for renegotiation and reimbursement satisfactory to the secretary of war or the secretary of the Navy, as the case may be". This amendment was subject to a point of order, and Congressman Case then offered a substitute amendment providing that final payment was not to be made "to any contractor who fails to file with the procuring agency a certificate of cost and an agreement for renegotiation of contract and reimbursement of profits in excess of 6 per cent". This amendment was adopted by the House of Representatives without debate. Mr. Case has stated that his proposals were modeled, in part, upon the renegotiation clauses developed by the procurement agencies (see par., 30 above). See Hearings before the Subcommittee of the Committee on Appropriations, U. S. Senate, 77th Cong., 2nd Sess. on H. R. 6868, pp. 89-92, 211-2.

33. At a hearing held on March 31 and April 1, 1942, by a subcommittee of the Senate Committee on Appropriations, on the Sixth Supplemental National Defense Appropriations Bill for 1942, representatives of the Government stated the objections to the Case amendment, as it then stood. General Somervell reviewed the factors making adequate pricing impossible in many cases and described the price adjustment procedures which had already been established in the War Department. The committee was informed that a Cost Analysis Section and a Price Adjustment Board had been set up and were at work and tentative policies and procedures had been laid down (Hearings pp. 24-25). The approved "redetermination" and "renegotiation" contract articles were also described to this subcommittee and their use explained. General Somervell, Mr. Donald Nelson, of the War Production Board, and other representatives of the procurement agencies again stated the objections to an inelastic profit-limitation provi-

sion of the type of the Case amendment. It was pointed out that the amount and rate of profit should depend—out of fairness to contractors and to furnish the proper incentive to reduce costs—on a number of factors, such as rapidity of turn-over, development costs, production time, money invested in the business, risks incurred, efficiency of production; a flat percentage limitation lumping all contractors together would not only be unfair to many and too generous to others but is subject to the very defects which have placed the cost-plus contract in disfavor; moreover, the statutory percentage of profit which is intended to be a maximum tends to become a minimum and contractors believe that they are entitled to receive that rate of profit.

34. The Senate subcommittee requested the procurement agencies to supply a substitute for the Case amendment. On April 2, 1942, General Somervell submitted a proposal on behalf of the War and Navy Departments and the War Production Board. A copy of this substitute proposal is attached as Exhibit I. The suggestion was based on the theory that if every contract price could be reexamined by the parties in the light of actual experience under the contract, it should be possible to eliminate the bulk of excessive profits. Section 403, as finally enacted, differs in many respects from our proposal, but it retains the central principle that a fixed percentage limitation on profits should not be established.

35. The War Department has consistently opposed the substitution of a 100 per cent excess profits tax in place of the renegotiation statute, for the same reasons for which we disapproved a flat percentage limitation on profits from war contracts. Our views are stated at length in the report of the Hearings before a Sub-committee of the Senate Committee on Finance on Section 403 of Public Law No. 528, September 29–30, 1942, 77th Congress, 2d Session, and the Hearings before the Committee on Naval Affairs, House of Representatives, pursuant to H. Res. 30, June, 1943, 78th Cong., 1st Sess. pp. 997–1000. The Introductions to the Renegotiation Regulations of the War Contracts Price Adjustment Board and to the Joint Renegotiation Manual approved by the Joint Price Adjustment Board also contain statements on this



point with which the War Department is in accord. In brief, the major objection to a 100 per cent excess profits tax is that it would remove all incentive to reduce costs or promote efficiency, and in this respect would tend to increase the cost of war procurement through the waste of manpower and resources so as to counterbalance any gain in tax collections.

36. The War Department has found that the Renegotiation Act is the most satisfactory and effective method of eliminating excess profits on war contracts. The Department has vigorously opposed the repeal of the statute.

CONTRACTS ON WHICH FINAL PAYMENT HAD NOT BEEN MADE  
ON APRIL 28, 1942.

37. At the end of April, 1942, the following amounts were obligated for contracts, but unexpended, by the Navy Department and the three major procurement services of the War Department:

Army Air Forces contracts, over .....	\$16,700,000,000
Ordnance Department contracts, over .....	10,000,000,000
Engineers contracts, over .....	4,000,000,000
Navy contracts, over .....	18,000,000,000
Total, over .....	48,700,000,000

These figures concern only the agencies listed; they do not include subcontracts; nor do they include sums actually paid prior to April 28, 1942, on contracts on which final payment was not made until after that date. The figures do, however, include sums owing on some contracts exempt from renegotiation under the statute, but such sums are relatively small.

38. On the whole, it is certain that, on April 28, 1942, there were outstanding uncompleted war contracts in a total figure considerably in excess of 50 billion dollars which would have been exempt from renegotiation if the statute had not been made applicable to contracts existing on April 28th but with respect to which final payment had not been made by that date.

39. It is impossible to give more than the most general data

concerning the life of the uncompleted contracts in existence on April 28, 1942. The average time required for the construction of the major types of projects (cantonments, airfields, ordnance plants) being constructed under the supervision of the corps of engineers in April, 1942 was from 7 to 18 months. A substantial proportion of the Ordnance contracts placed during the first four months of 1942 extended for over six months; some of these contracts contemplated production extending over a period as long as two years. The Navy Department estimates that at least one-third of its funds which were obligated but unexpended on April 30, 1942, represented contracts requiring 12 months or longer for performance.

#### EXCESSIVE PROFITS ELIMINATED BY RENEGOTIATION.

40. As of September 19, 1944, 34,966 contractors had been assigned for renegotiation with respect to fiscal years ending during the calendar year 1942. As of the same date, 35,200 contractors had been assigned for such renegotiation with respect to fiscal years ending during the calendar year 1943. Of the cases assigned with respect to fiscal years ending in the calendar year 1942, relatively few remain uncompleted; and the renegotiation agencies are well along toward completion of the cases assigned with respect to fiscal years ending in the calendar year 1943.

41. As of September 22, 1944, in 7,949 cases excessive profits had been determined by agreement between the contractor and the Government, and at that date in 207 cases excessive profits had been determined by unilateral action by the Government without the agreement of the contractor. Thus, 97.5 per cent of the cases in which excessive profits had been determined involved bilateral agreements in which the contractor joined. These figures do not include the cases, of which there are a large number, in which no excessive profits were found or in which the renegotiation proceedings were cancelled as the result of information indicating no excessive profits. It should be noted, too, that the number of contractors affected by the bilateral agreements exceeds the number of 7,949, since many of these agreements affect groups of parent and subsidiary corporations.

42. It is impossible at the present time to give complete figures as to the dollar volume of the sales covered by the cases in which excessive profits have been determined. As of September 16, 1944, in the 7,733 cases concluded by bilateral agreement or unilateral determination (excluding Army construction contracts), the aggregate renegotiable sales of the contractors affected (prior to adjustment for excessive profits eliminated) were \$30,975,405,000. Excessive profits eliminated in these cases amounted to \$3,586,652,000. In addition, approximately \$57,000,000 in excessive profits had been recovered from construction contractors assigned to the chief of engineers for renegotiation. These figures do not take account of reductions in Federal taxes occasioned by the elimination of excessive profits through renegotiation.

43. The figures in the preceding paragraph do not include excessive profits eliminated (a) by refunds made to contracting officers prior to and unrelated to statutory renegotiation, (b) by reduced prices with respect to future performance or deliveries under existing contracts, or (c) by reduced prices under new contracts. No statistical data are available as to the amounts of excessive profits so eliminated or prevented, but they have been substantial, and run into many hundred millions of dollars.

44. The data contained in paragraphs 40 to 43 cover renegotiations carried on by all agencies and not merely those in which the War Department is interested.

#### RENEGOTIATION PROCEDURE.

45. From the very beginning of statutory renegotiation by the War Department, the attempt has always been made to secure the full cooperation of the contractor in the process of renegotiation. It has been the uniform practice to explain the purposes, policies, and methods of renegotiation to contractors and to elicit their participation both in the furnishing of information and in the drawing up of an agreement as to excessive profits. Although Title XIII of the Second War Powers Act, 1942, grants the Government certain powers to secure the pertinent records and data, on which renegotiation must be based, from recalcitrant contrac-

tors, we have always sought to obtain this information voluntarily, and without unduly hampering the contractor's activities. Similarly, although the statute empowers the renegotiation agencies to determine excessive profits unilaterally, it has always been our policy to renegotiate, in the literal sense, and to seek a bilateral agreement with the contractor, whenever possible.

46. In most cases, renegotiation in the War Department (for fiscal years ended on or prior to June 30, 1943) was conducted initially by Price Adjustment Sections of the Technical Services (e.g., Ordnance Department, Signal Corps, Chemical Warfare Service) and the Army Air Forces. If the initial renegotiation proceedings did not result in an agreement with the contractor or if a bilateral agreement was proposed in cases where the contractor's gross sales were more than \$10,000,000, the case was always referred to the War Department Price Adjustment Board. I am advised that the Board, in every case in which a contractor requested a meeting with representatives of that Board, accorded the contractor that opportunity. Until April 12, 1945, if an agreement could not be reached between the representatives of the Board and the contractor, the case was then referred, together with a full report, to me as under secretary of war. It was my practice to refer such case, for initial review, to one of my principal assistants, not otherwise connected with renegotiation. This assistant invariably allowed the contractor, upon the latter's request, to meet with him before he made any recommendation to me; and in this meeting the contractor could present any pertinent material not previously furnished and discuss the matter from the contractor's point of view. I personally made the final determination that excessive profits had been made in every case in which a unilateral determination was signed by me. The last hearing conducted by an assistant of mine under this procedure was held on April 12, 1945. On April 11, 1945, I delegated to the chairman of the War Department Price Adjustment Board the power to make unilateral determinations under the Renegotiation Act. I am informed that, pursuant to that delegation, the War Department Price Adjustment Board has established a determination



committee consisting of the six War Department members of the Board. That committee, as I am informed, has granted and will grant contractors an opportunity for a meeting with two members of the committee, appointed by the chairman for that purpose, before a final determination is made in any case where the committee disapproves the determination recommended by the representatives of the Board who met with the contractor initially. In sum, opportunity is always afforded the contractor for discussions with representatives of the renegotiating agency and the presentation of pertinent data and argument. No unilateral determination has ever been made without the contractors having been offered the opportunity, at some stage and in substantially all cases at several stages in the renegotiation process, to present his views and discuss the matter.

ROBERT P. PATTERSON.

Sworn to and subscribed before me this third day of August, 1945.

EDWARD L. DAVIS,

[SEAL]

Notary Public, D. C.

My commission expires July 14, 1946.

#### EXHIBIT A.

#### W. P. B. RECORD OF MONTHLY AWARDS OF PRIMARY WAR SUPPLY CONTRACTS.

Date	Total	Number of contracts			All others
		Aircraft	Ships	Ordnance	
1941					
July .....	1,124	40	40	202	842
Aug. ....	1,352	62	77	264	949
Sept. ....	1,476	78	68	223	1,107
Oct. ....	1,824	97	49	305	1,373
Nov. ....	1,566	94	67	321	1,084
Dec. ....	1,885	116	63	384	1,322
1942					
Jan. ....	3,612	132	156	836	2,488
Feb. ....	3,656	136	165	710	2,645

Mar. ....	4,188	162	161	765	3,100
Apr. ....	4,866	187	197	795	3,687
May ....	3,597	114	126	459	2,898
June ....	3,657	143	171	439	2,904

## Value (millions of dollars)

1941					
July .....	1,057	92	129	551	285
Aug. ....	1,842	688	237	636	281
Sept. ....	1,335	386	159	436	353
Oct. ....	2,404	1,264	107	569	464
Nov. ....	1,506	261	288	461	495
Dec. ....	3,131	985	406	1,150	589

1942					
Jan. ....	9,456	2,435	2,092	4,015	914
Feb. ....	7,301	3,628	893	1,891	889
Mar. ....	5,343	1,440	728	1,842	1,333
Apr. ....	5,715	1,234	1,014	1,808	1,659
May ....	4,843	1,337	759	1,530	1,216
June ....	5,299	937	1,249	1,709	1,404

**EXHIBIT B.****WAR DEPARTMENT**

Office of the Under Secretary Washington, D. C.

January 14, 1942.

PC-E-400.13 (Procurement).

P. &amp; C. General Directive No. 8.

Memorandum for: The Chief of the Air Corps.

The Chief, Chemical Warfare Service.

The Chief of Coast Artillery.

The Chief of Engineers.

The Chief, National Guard Bureau.

The Chief of Ordnance.

The Quartermaster General.

The Chief Signal Officer.

The Surgeon General.

Subject: Selection of contractors for war production.

1. The heavy procurement program and need for speed in production make vital the best utilization of every facility. As a limited number of facilities are able to undertake precision work, care must be exercised in allocating only such work to them, each plant to undertake the highest caliber of work its equipment can produce.

2. In awarding prime contracts, great weight must be placed upon the contractor's agreement to subcontract a high percentage wherever this is feasible. Unless secondary facilities are thus put to work on the simpler components, difficulty will later be encountered in placing prime contracts calling for precision work. The best results will be obtained by insisting upon such subcontracting at the time of the award of the prime contract as efforts to have prime contractors subcontract simpler components at a later date may be only partially successful after work has been started.

3. In many cases requirement of subcontracting will add to the total cost. Price is a secondary consideration as compared with speed and efficient production. Reasonable increase in price which will speed the program through subcontracting is justified. Because of the increase in price, subcontracting should be taken into account in making the award and should be provided for in the prime contract, where possible, rather than to assume that it can be arranged after the award has been made.

4. Speed in placing orders now authorized is important, but speed of production as a whole during the next 18 months is of even greater importance. Accordingly, under our present decentralized procurement policy the chiefs of the supply arms and services and their district procurement offices must exercise their best judgment in the matters mentioned in paragraphs 1, 2 and 3 above. War calls for the same boldness and imagination in procurement as it does in meeting combat conditions in the field.

By direction of the Under Secretary of War:

(S) JOHN W. N. SCHULZ,

Brigadier General, U. S. Army,  
Director of Purchases and Contracts.

## EXHIBIT C.

War Department .

Office of the Under Secretary, Washington, D. C.

September 17, 1941.

PC-L 162 (Escalator Clause).

P. &amp; C. General Directive No. 48.

Memorandum for The Chief of the Air Corps.

The Chief, Chemical Warfare Service:

The Chief of Coast Artillery.

The Chief of Engineers.

The Chief, National Guard Bureau.

The Chief of Ordnance.

The Quartermaster General.

The Chief Signal Officer.

The Surgeon General.

Subject: Price Adjustment Clause

1. Price Adjustment articles (escalator clauses) will be included in supply contracts only in exceptional cases where the facts justify their use. In determining the justification for the inclusion of such a clause, the following factors, among others, should be given consideration:

a. The inclusion of an escalator clause should result in a lower contract price than if such a clause were not included. Before consenting to the inclusion of an escalator clause in a contract, the contracting officer should satisfy himself that the contractor has not included in the contract price any amount to cover probable increased direct labor or direct materials costs.

b. The time required for the performance of the contract should be such as to make it impossible to forecast with reasonable accuracy the extent of changes in the direct labor or direct materials cost under the contract. Ordinarily the time of performance should not be less than six (6) months.

c. The contract should be of sufficient amount to warrant



the administrative expenses which would be incurred in administering the escalator clause. As a general rule, contracts for less than \$100,000 would not warrant such expenditure.

2. Attached hereto are copies of the Price Adjustment article (escalator clause) as approved by the Under Secretary of War on September 13, 1941, for use in supply contracts hereafter entered into where it has been determined that an escalator clause should be included. Any deviations from this form will be made only after approval in each case by the Under Secretary of War. Requests for such approval will be accompanied by a detailed statement of the facts and reasons justifying such deviation.

3. All contracts containing this escalator clause will also contain an article providing for termination of the contract for the convenience of the Government.

4. It is desired that the foregoing instructions be communicated promptly to all contracting agencies in your branch.

By direction of the Under Secretary of War:

(S) JOHN W. N. SCHULZ,  
John W. N. Schultz,  
Brigadier General, U. S. Army,  
Director of Purchases and Contracts.

Incls.

cys. Price Adjustment Clause.

FORM OF ESCALATOR CLAUSE APPROVED BY THE UNDER  
SECRETARY OF WAR, SEPTEMBER 13, 1941

Article ..... Price Adjustments.

The total contract price stated in Article ..... is subject to adjustment for increases or decreases in direct labor and direct material costs in accordance with the following method:

(a) Labor.

(1) Upon the basis of labor costs prevailing in ..... 194. . (hereinafter called the base month) the direct labor cost is estimated to be \$. . . . . Direct labor, as used herein, refers only to the labor of employees of the Contractor performed

directly on, and properly chargeable to, the supplies manufactured hereunder, excluding, but without limitation, all executive, managerial, supervisory, technical, professional, office, clerical and sales employees, but including working foremen, gang-bosses and straw-bosses. The Contractor represents that the above estimated cost is based upon a schedule, approved by the Contracting Officer, of the kinds or classes of jobs or occupations to be charged as direct labor under this contract, and that the estimate includes only such jobs or occupations. In computing the actual direct labor cost for the purposes of paragraph (a) (2) and (a) (3) hereof, the cost of kinds or classes of jobs or occupations not listed in this schedule, a copy of which is attached hereto, shall not be included.

(2) After deliveries under this contract have been completed, the estimated direct labor cost set forth above shall be apportioned into direct labor cost quotas for the consecutive three-month periods (hereinafter called "quota periods") beginning on the first day of . . . . ., 194: ,<sup>1</sup> and on the first day of each third month thereafter. This apportionment shall be made by dividing the actual direct labor cost properly charged to this contract during each quota period by the total actual direct labor cost under the contract, and by multiplying the percentage thus obtained for each quota period by the total estimated direct labor cost. The result shall be the direct labor cost quota for that period.

(3) Upon the basis of the average hourly earnings in the durable goods manufacturing industries compiled by the United States Department of Labor, Bureau of Labor Statistics, the Government will determine the average hourly earning for each quota period by adding the average hourly earnings for each month of such quota period and dividing their sum by three, and calculations will be made of the percentage of change of such average hourly earnings for each quota period in comparison with the average hourly earnings for the base month. The labor cost quota

<sup>1</sup> The month during which the contract is executed or performance is commenced, whichever is earlier.

for each quota period will then be multiplied by the percentage of change for such quota period, and the result will be applied as an increase or decrease in the contract price; Provided, That the total of such increases in the contract price shall not exceed the amount by which the total actual direct labor cost exceeds the total estimated direct labor cost, and that the total of such decreases in the contract price shall not exceed the amount by which the total actual direct labor cost is less than the total estimated direct labor cost.

(b) Materials.

(1) Upon the basis of materials costs prevailing in the base month, the cost of direct materials which the Contractor will purchase for the performance of this contract, excluding materials to be used which the Contractor has on hand or for which firm price commitments have been obtained by him (hereinafter call "direct materials to be purchased hereunder"), is estimated to be \$ . . . . . (hereinafter called "estimated adjustable materials cost"). Direct materials as used herein refers only to those materials which go into and become a component part of the Contractor's finished product and which, under the cost accounting system regularly employed in the Contractor's plant, are accounted for by direct charges to the particular contract. The Contractor represents that the above estimate is based upon a schedule, approved by the Contracting Officer, of the kinds and classes of "direct materials to be purchased hereunder." In computing the actual cost of "direct materials to be purchased hereunder" for the purposes of paragraphs (b) (2) and (b) (3) hereof, the cost of kinds or classes of materials not listed in this schedule, a copy of which is attached hereto, shall not be included.

(2) After deliveries under this contract have been completed, the "estimated adjustable materials cost" shall be apportioned into materials cost quotas for the quota periods as defined in paragraph (a) (2) above. This apportionment shall be made by dividing the total actual cost of "direct materials to be purchased hereunder" into the portion of such cost properly charged to the contract during each quota period, and by multiplying the percentage thus

obtained for each quota period, by the total "estimated adjustable materials cost." The result shall be the materials cost quota for that period. Direct materials shall be charged to the contract for the quota period during which the price therefor is determined as between the Contractor and the materials supplier; Provided, That where commitments are obtained by the Contractor for future deliveries at a firm price in excess of the market price prevailing at the time such commitments were obtained, such materials shall be charged to the contract for the quota period during which delivery is to be received by the Contractor; And, Provided further, That with respect to materials which are not identifiable with the purchase commitments under which they are acquired, determinations as to (1) whether the materials employed in the performance of this contract were on hand at the time the contract was executed, and (2) the quota period to which the materials are to be charged and the amount of such charge shall, with the approval of the Contracting Officer, be made on the basis of the accounting system regularly employed in the Contractor's plant.

(3) The Government will average for each quota period the index numbers of wholesale prices for .....<sup>2</sup> compiled by the United States Department of Labor, Bureau of Labor Statistics for the three months included within such quota period, and calculations will be made of the percentage of change of such average index numbers for each quota period in comparison with the index numbers for the base month. The materials cost quota for each quota period shall then be multiplied by the percentage of change for such quota period; and the result will be applied as an increase or decrease in the contract price; Provided, That the total of such increases in the contract price shall not exceed the amount by which the actual cost of "direct materials to be purchased hereunder" exceeds the total "estimated adjustable materials cost", and that the total of such decreases in the contract price shall not exceed the amount by which said total actual cost of "direct mate-

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<sup>2</sup> The index for the commodities group which includes the items making up the major portion of the "direct materials to be purchased hereunder".



rials to be purchased hereunder" is less than the total "estimated adjustable materials cost."

(c) General.

(1) For the purpose of determining increases or decreases in contract prices, rates of change in average hourly earnings and rates of change in the materials index number will be calculated to the nearest one-tenth of one per cent, and there shall be used the latest figures which shall have been issued by the Bureau of Labor Statistics up to the close of the fourth month following the last quota period under this contract.

(2) Payments for increases, or deductions for decreases in the contract price, resulting from the operation of this article, will be made after the completion of the calculations of price adjustments in accordance herewith; Provided, That the Government may, from time to time during the life of the contract, make partial payments on account of such increases, subject to such requirements as a condition precedent to such payments, as the Contracting Officer may provide; Provided, further, That in this event such partial payments shall exceed the amount due to the Contractor by the operation of this article, the Government shall deduct the amount of such excess from any further payments due under this contract.

(3) Should the Contractor, during the performance of this contract, on account of subcontracting, or otherwise, depart from the production methods upon which the estimates and schedules of direct labor and direct materials cost were based to such an extent that the use of such estimates or schedules will operate to produce an unfair adjustment of the contract price, a corresponding correction in such estimates or schedules may be made by mutual agreement between the Contractor and the Contracting Officer. In the event of disagreement with respect to the need for or extent of such correction, the procedure of Article 12 (Disputes) shall apply.

(4) If this contract is terminated pursuant to any provision thereof the contract price shall be adjusted as provided above, except that for the purposes of paragraphs (a) (2), (a) (3), (b)

(2), and (b) (3), the terms "estimated direct labor cost" and "estimated adjustable materials cost" shall be understood to refer to that part of such costs which corresponds to that proportion of the supplies contracted for which is completed and delivered by the Contractor, and the terms "actual direct labor cost" and "actual cost of direct materials to be purchased hereunder", shall refer only to that part of such costs which is properly chargeable to the supplies completed and delivered.

(5) The Contractor shall file with the Contracting Officer, not later than sixty days after the completion of the performance of the work under this contract or after its termination, a statement of the actual direct labor costs and the actual costs of "direct materials to be purchased hereunder," certified as correct by an independent public accountant approved by the Contracting Officer, showing the amounts of such costs properly chargeable during each quota period and, in case of termination, the amounts properly chargeable to the supplies completed and delivered. In determining the total actual direct labor cost and the total actual "direct materials to be purchased hereunder," and in determining the amounts thereof to be charged in each quota period, the Contractor may, subject to the approval of the Contracting Officer and to the limitations of paragraph (b) (2), employ the accounting system regularly employed in the Contractor's plant. Such statement shall be deemed prima facie correct. The Government reserves the right to audit the books and records of the Contractor, to determine the accuracy of such determinations and certification, and to obtain any information in connection with the operation of this Article. All information obtained from the Contractor's records shall be treated as confidential. The Contractor shall preserve all the books, papers, and other accounting records pertaining thereto; Provided, that if the Contractor at any time after the lapse of three years following the completion or cessation of work under the contract, desires to dispose of said books, papers, and accounting records, he shall so notify the Secretary of War, or his duly authorized representative, who shall either authorize their

destruction or notify the Contractor to turn them over to the Government for disposition.

**EXHIBIT D.**

War Department

Office of the Under Secretary Washington, D. C.

PC-L 162.

December 17, 1941.

P. & C. General Directive No. 86.

Memorandum for: The Chief of the Air Corps.  
The Chief, Chemical Warfare Service.  
The Chief of Coast Artillery.  
The Chief of Engineers.  
The Chief, National Guard Bureau.  
The Chief of Ordnance.  
The Quartermaster General.  
The Chief Signal Officer.  
The Surgeon General.

Copy to: The Judge Advocate General—for information.

Subject: Amendment to Price Adjustment Clause.

1. Reference is made to the form of escalator clause approved by the Under Secretary of War on September 13, 1941, accompanying P. & C. General Directive No. 48.

2. It has been determined that the escalator clause should be amended so as to provide for adjustments on account of changes in pay-roll taxes, and therefore, the approved form of escalator clause will be amended by adding the following provision thereto as paragraph (c) (6):

If after the date on which the prices herein were quoted, the Congress or any state legislature, shall impose, remove, increase or decrease any pay-roll tax required to be borne by the contractor and directly applicable to or measured by the pay-rolls of the contractor hereunder, then the rate of such newly imposed tax, or the net increase or net decrease in the rate of a previously imposed tax, shall be multiplied by that

portion of the actual direct labor cost which is subject to such increases or decreases in the tax or taxes, and the result shall be paid the contractor under this paragraph.

3: It has also been determined that the escalator clause should be amended so as to provide for adjustment on account of changes in indirect labor and indirect material costs. Accordingly, the following amendments to the approved form of escalator clause will be made:

a. As a second sentence to Paragraph (a) (1), add the following:

"It is also estimated that the indirect labor cost attributable to this contract is .....% of such estimated direct labor cost."

b. Add the following as Paragraph (a) (4):

"The total increase or decrease to be paid or deducted under Paragraph (a) (3) shall be multiplied by .....%<sup>1</sup> and the result shall be applied as a further increase or decrease in the contract price, as an adjustment for the indirect labor cost under this contract."

c. Add the following as the second sentence in Paragraph (b) (1):

"It is also estimated that the indirect materials cost attributable to this contract is .....% of such estimated direct materials cost."

d. Add the following as Paragraph (b) (4):

"The total increase or decrease to be paid or deducted under Paragraph (b) (3) shall be multiplied by .....%<sup>2</sup> and the result shall be applied as a further increase or decrease in the contract price, as an adjustment for the indirect materials cost under this contract."

4. In negotiating the estimated direct labor cost, the percentage

<sup>1</sup> The percentage of indirect labor cost stated in Paragraph (a) (1).

<sup>2</sup> The percentage of indirect materials cost stated in Paragraph (b) (1).



thereof represented by indirect labor cost, the estimated direct material cost, and the percentage thereof represented by indirect material cost, the Contracting Officer should consider, among other things, the following factors:

a. The amount of the estimated direct labor cost and the amount of the estimated direct materials cost should be limited in accordance with the definitions of direct labor and direct material costs contained in paragraphs (a) (1) and (b) (1) of the escalator clause, and should not include any amounts for indirect labor or indirect material costs;

b. The total of the estimated direct labor cost and the estimated direct material cost, together with the amounts obtained by the application of the percentages set forth for indirect labor and indirect materials, should bear a reasonable relation to the total contract price. In any case where the difference between the total of these amounts and the contract price does not leave a reasonable margin to cover profit, rent, depreciation, taxes, and similar costs not included in the labor or material costs factors, it will be apparent that the estimates are too high, and should be accordingly reduced.

By direction of the Under Secretary of War:

[S] JOHN W. N. SCHULZ,

Brigadier General, U. S. Army,  
Director of Purchases and Contracts.

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EXHIBIT E.

War Department Price Adjustment Board  
Policy and Procedure

Purpose of the Board.

The Price Adjustment Board will serve as a focal point for the review of contracts existing between the War Department and its contractors. Its duties will be to make sure that the War Department is doing an economical job of purchasing and that contractors are not making excess or unreasonable profits on war orders. In

its review of contractor profits the Board will endeavor to eliminate from contractor cost calculations exorbitant items of whatever nature.

The Board will assist the Services in securing an adjustment in contract prices that will accomplish the foregoing objectives.

The Board will also serve contractors who feel that their contract prices are such that a likelihood exists that they will make excessive or unreasonable profits. It will invite war contractors finding themselves in this position to consult with it for the purpose of arriving at a fair and equitable voluntary adjustment.

#### Operating Policies.

The following principles will be observed by the Price Adjustment Board in dealings with contractors:

1. The Board will endeavor to arrange for a readjustment in contract price or to obtain a return of payments made pursuant to a contract to the extent which will result in limiting the contractor to a fair and reasonable profit.

2. In judging the reasonableness of profit, the Board will consider:

- (a) the total profit made by the contractor before allowance for federal income and excess profit tax.

- (b) the amount of profit per unit based on estimated or actual cost.

3. In determining the estimated or actual cost per unit of performance of the contract, the Board will give consideration to all items of cost, including the following:

#### A. Factory Cost:

1. Direct materials
2. Direct productive labor
3. Direct engineering labor
4. Miscellaneous direct factory charges
5. Indirect factory expenses

Total Factory Cost

#### B. Other manufacturing cost

- C. Miscellaneous direct expenses
- D. Indirect engineering expenses
- E. Expenses of distribution, servicing and administration
- F. Guarantee expenses

4. The Board will in general be guided by the cost accounting system regularly utilized by the contractor, except that the Board will, in appropriate cases, disallow salaries, bonuses or other expenditures which are clearly excessive.

5. In determining the amount of profit to be viewed as reasonable, the Board will give proper consideration the following:

A. The first factor in determining the attitude of the Board toward the contractor will be based on the contribution that the contractor has made and is making to the completion of the war production program.

B. Whether the contract is performed in whole or in part with facilities furnished by or financed by the Government.

C. The amount of invested capital employed by the contractor in the performance of the contract.

D. The ratio between this investment and sales volume.

E. The period of time required to perform the contract.

F. The complexity or simplicity of the manufacturing operations involved.

G. The presence or absence of exceptional risks to be borne by the company.

H. The degree of skill and management and organization required of the contractor. In this connection special attention will be paid to the extent to which the Government has been called upon to arrange for furnishing "know-how" to the contractor.

I. The contribution that the contractor has made to the technical improvement and development of war material and production methods.

J. Special consideration will be given those contractors who have assisted other producers in performing a better job.

6. In cases where performance has been substantially or wholly

completed, consideration will be given to the extent to which the contractor has met or anticipated delivery schedules.

7. The Board shall not be limited to the foregoing factors but may give consideration to any other factors which in its judgment are reasonably applicable.

#### Method of Operation.

Information as to concerns making unreasonable profits or those paying excessive salaries or bonuses, or setting up excessive reserves, etc., will be obtained by the Board from the services, Division of Budget & Financial Administration, Contract Clearance Branch of the War Production Board, or any other sources.

All costs analyses are to be prepared by the Division of Budget and Financial Administration.

When the contractor is working for the Navy or the Maritime Commission as well as the Army, that department which has been assigned to the contractor will take charge of the case.

The Price Adjustment Board function will be completed when an agreement is arrived at with the contractor setting a limiting figure that shall be considered a reasonable profit before federal income and excess profit taxes. From this point forward, it is contemplated that the contractor will renegotiate contracts with the Service or Services involved so as to bring its total profit down to the agreed upon figure.

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#### EXHIBIT F.

#### MEMORANDUM

Pursuant to Executive Order No. 9127, dated April 8, 1942, and for the purpose of controlling profits and costs under war contracts through adjustments with contractors, there have been established with the War Production Board, the War Department, the Navy Department and the Maritime Commission cost analysis sections. Further to implement control of costs and profits on war contracts, the following procedures will be established:

1. The War Department and the Navy Department and the Maritime Commission will each create a board to be



known as the Price Adjustment Board of the War Department, the Navy Department, or the Maritime Commission, as the case may be, to advise and assist the official in such Department or Commission in charge of purchasing, in securing adjustments or refunds in instances where it is determined that costs or profits of contractors are, or may be, excessive for any reason. Each board shall exercise such other powers not inconsistent with this order as may be delegated to it by the Department or Commission which created it.

2. The Chairman of the War Production Board shall recommend a representative for appointment to each board. The Price Adjustment Boards may have one or more members in common.

3. The Cost Analysis Section of the War Production Board will conduct general surveys of the profits and costs of holders of war contracts and industry-wide studies of a like nature, either upon the request of one of the Price Adjustment Boards, or of the Cost Analysis Section of any Department, or upon its own initiative.

4. The Cost Analysis Sections of the War Department, Navy Department and the Maritime Commission will act as fact finding agencies for the Price Adjustment Boards and will upon the request of any Price Adjustment Board conduct investigations into the cost and profits of any contracts in which Departments or the Commission are interested. Any such investigation made upon the request of a Price Adjustment Board will be in such form and in such detail and will include such subject matter as such Price Adjustment Board may require. The Departments and the Commission will cooperate with each other in order to avoid duplicating investigations of common contractors.

5. All cost analysis reports and all information obtained from contractors or otherwise by the various Cost Analysis Sections including that of the War Production Board and all information and records of the various Price Adjustment

Boards will be available at all times to each of the Price Adjustment Boards and to each of the Cost Analysis Sections.

6. The Cost Analysis Sections of the War Production Board and of the Departments and the Commission are authorized to make use of the facilities of the Treasury Department, Securities and Exchange Commission, Federal Trade Commission and other proper departments or agencies of the Government in securing and assembling information.

7. Each Price Adjustment Board may establish such policies and procedures for the administration of its proceedings as it may deem proper. Every effort shall be made to keep the procedure of each board simple and flexible. Each board shall keep a written record of each action taken by it. Each board may delegate to any one or more of its members the power to initiate investigations, request information and assistance on behalf of the board and to represent the board in negotiations with contractors.

8. Where contractors have contracts with both Departments or with one or both of the Departments and the Commission, the Price Adjustment Boards of the Department or Commission involved shall agree as to how and by whom the negotiations shall be conducted.

9. No audit shall be made by any Department or the Commission pursuant to Executive Order No. 9127 without first advising the Cost Analysis Section of the War Production Board.

(Signed) ROBERT P. PATTERSON,

Under Secretary of War.

(Signed) FORRESTAL,

Under Secretary of Navy.

(Signed) E. S. LAND,

Chairman, Maritime Commission.

Approved:

(Signed) D. M. NELSON,

Chairman, War Production Board.

## EXHIBIT G.

War Department Washington

April 25, 1942.

Memorandum for Directors of all Staff Divisions, Services of Supply.

Chiefs of All Supply Services.

Chief of Each Administrative Service.

Commanding Generals of All Corps Areas.

Subject: Price Adjustment Board, Services of Supply.

1. There is created within the Services of Supply a Price Adjustment Board.

2. The mission of the Price Adjustment Board shall be to advise and assist the Chief of the Purchase Branch, Procurement and Distribution Division, in securing adjustments and refunds in cases where it is thought that costs or profits of War Department contractors are or may be excessive by reason of the payment of excessive salaries or bonuses or for any reason.

3. The members of the Board will be selected by the Commanding General, Services of Supply, with the approval of the Under Secretary of War. One member will be selected with the approval of the Chairman of War Production Board, as his representative.

4. The Board is instructed wherever appropriate to function jointly with representatives or agencies of the Navy Department, Maritime Commission, and other Departments or agencies of the Government.

5. The Board will receive from the Cost Analysis Section of the War Production Board, the Cost Analysis Section of the Fiscal Division of the Services of Supply, the Supply Services, the Army Air Force, and from any other source, information with respect to contractors who are thought to have excessive costs, to be making excessive profits, or to be paying excessive salaries or bonuses.

6. (a) The Cost Analysis Section of the Fiscal Division of the Services of Supply shall upon request of the Board make such audits and analyses as may be designated by the Board and shall secure for the Board from the Treasury Department, the Securities

and Exchange Commission, the Federal Trade Commission, and from any other Department or agency of the Government, or from the contractor involved, such additional information as the Board may request in order to expedite and assist it in the performance of its functions.

(b) All Divisions and personnel of the Services of Supply and the Army Air Force shall furnish such information and assistance to the Board as it may request or as may appear desirable to aid it in the performance of its functions.

(c) To effect full coordination between the Services of Supply, the Army Air Force, and other Departments and to insure a uniform policy, price reductions which are offered to or contemplated by, the Services of Supply and the Army Air Force will be referred to the Chief of the Purchases Branch.

7. The Board is authorized to delegate to any one or more of its members the power to initiate investigations and request information and assistance on behalf of the Board and to represent the Board in negotiations with contractors. The Board shall develop such other policies and procedures as it may deem advisable in performing its functions and accomplishing its purposes.

8. The Board shall report to the Chief of the Purchases Branch, Procurement and Distribution Division, Services of Supply, its recommendations for adjustments with contractors. These recommendations, if approved by the Chief of the Purchases Branch and the Director or Deputy Director of the Procurement and Distribution Division, Services of Supply, shall be transmitted to the Services concerned for the purpose of effecting any renegotiation or revision of contracts required in order to carry out such recommendations.

(Sgd.) BREHON SOMERVELL,  
Brehon Somervell,

Lieutenant General,  
Commanding.

Approved: April 25, 1942.

(Sgd.) ROBERT P. PATTERSON,  
Robert P. Patterson,

Under Secretary of War.



## EXHIBIT H.

War Department  
Headquarters, Services of Supply Washington

March 13, 1942.

SP-PB-ppp 300.4.

P. B. General Directive No. 31.

To: The Chief, Chemical Warfare Service.

Chief of Engineers.

Chief of Ordnance.

The Quartermaster General.

Chief Signal Officer.

The Surgeon General.

Commanding General, Transportation Division.

Commanding Generals, all Corps Areas.

Commanding Officers, General Depots.

Subject: Use of Price Renegotiation Clause in Fixed Price  
Contracts.

1. It is essential to eliminate all delays in the production of items immediately required which result from the time required for the negotiation of fixed price contracts. In any case where in the opinion of the Contracting Officer it is desirable that the Contractor immediately commence production or preparation therefor, the Letter Purchase Order prescribed by P. & C. General Directive No. 5, dated January 13, 1942, may be issued pending such negotiation. Where actual production and delivery may occur prior to the execution of the contract, the words "partial payments and" or words of substantially similar import may be inserted in paragraph 4 of such Letter Purchase Order before the words "advance payments".

2. Where a Letter Purchase Order is employed in accordance with paragraph 1 hereof, the contract should be negotiated at the earliest possible date even though final determination of price is impracticable at that time, and provision should be made in the contract for redetermination or renegotiation of the price, as authorized herein.

3. The Contracting Officer, in order to facilitate the execution of the contract and the commencement of work thereunder, may, pursuant to the authority of the First War Powers Act, 1941 (Public 354, 77th Cong.) and Executive Order No. 9001, insert in the contract and apply either of the following articles: (a) Redetermination of Price (Attachment 1), or (b) Renegotiation (Attachment 2).

4. It will be observed that Attachment 2 imposes upon the Contractor no legal obligation beyond that of furnishing a statement of actual costs and to renegotiate in good faith. Such statement will afford a basis for renegotiation of the contract price. On the other hand, Attachment 1 calls for the application of definite objective standards, thereby making the redetermination of price largely automatic rather than dependent upon renegotiation.

(Sgd) BREHON SOMERVELL,

Lieut. General,  
Commanding.

2 Incls:

Attach. 1,

Attach. 2.

Approved by:

ROBERT P. PATTERSON,

Under Secretary of War.

Attachment No. 1.

Article ..... Redetermination of Price.

The parties hereto recognize that, because of circumstances beyond their control, accurate estimates of the cost of performing this contract cannot be made within a reasonable time. Accordingly, they agree that the price stated in Article 1 shall be redetermined as provided below, upon the basis of the actual experience of the Contractor in performing part of his contract. Such redetermination of the price shall be made as follows:

(a) The estimated cost of performing this contract, upon which

the price stated in Article 1 is based, is \$ . . . . . , itemized as follows:<sup>1</sup>

A. Factory Cost:

1. Direct materials
2. Direct productive labor
3. Direct engineering labor
4. Miscellaneous direct factory charges
5. Indirect factory expenses<sup>2</sup>

(State basis of allocation)

Total Factory Cost

B. Other manufacturing cost

C. Miscellaneous direct expenses

D. Indirect engineering expenses

E. Expenses of distribution, servicing and administration

F. Guaranteed expenses

(b) It is agreed that the cost of production of the first . . . . . % of items called for hereunder, hereafter referred to as the "preliminary run" will not necessarily be typical for the remainder of the contract. The cost of production of the next . . . . . %, hereafter referred to as the "test run" shall be used as the general basis for redetermination. Within . . . . . days after the completion of the production of the "test run"; the Contractor shall submit to the Contracting Officer separate statements of the actual cost of the production of the "preliminary run" and the "test run", itemized in the same way as the estimated cost stated above. Such statement shall be based upon the cost accounting system regularly utilized by the Contractor and certified as correct by an independent public accountant or by two officers of the Contractor. The Contractor shall submit his books and accounts

<sup>1</sup> This breakdown may be altered to suit particular circumstances.

<sup>2</sup> State separately the estimated amount of each of the following items included:

- (a) Normal depreciation.
- (b) Special amortization.

to such examination and audit as shall be requested by the Contracting Officer.

(c) If the actual cost of production of the preliminary run plus the cost of the production of the remainder of the items called for by the contract, as indicated by the actual cost of production of the "test run", is less than the total estimated cost stated in paragraph (a), the total price to be paid pursuant to Article I shall be reduced in the same ratio.

(d) Pending the redetermination of the price hereunder, all items delivered shall be paid for at the price set forth in Article 1. Upon the redetermination of such price hereunder, an amount equal to the difference between the price paid on all items theretofore delivered and such redetermined price for such items shall be applied by the Contractor as a credit against payment for subsequent deliveries, or shall be applied or returned to the Government as directed by the Contracting Officer.

(e) If this contract contains an escalator clause (Price Adjustment), notwithstanding any provisions of such escalator clause which may be inconsistent herewith, that clause shall be understood to relate only to that portion of the production under the contract which is not covered by the statements of actual cost required by paragraph (b) of this article. The blanks in the escalator clause will be filled in at the time of redetermination hereunder, and the month in which the redetermination is made shall be taken as the base month for such escalator clause and the estimated labor costs and the estimated material costs shall include only such costs as are not reflected in the actual cost statements. For this reason the blanks in the escalator clause were not filled in at the time of the execution of this contract.

Attachment No. 2:

Article ..... Renegotiation.

(a) The Contractor represents that the contract price provided in Article ..... is based upon a total estimated cost of \$ ..... itemized as follows:<sup>1</sup>

<sup>1</sup> This break-down may be altered to suit particular circumstances.



## A. Factory Cost:

1. Direct materials
2. Direct productive labor
3. Direct engineering labor
4. Miscellaneous direct factory charges
5. Indirect factory expenses.<sup>2</sup>

(State basis of allocation)

Total Factory Cost

B. Other manufacturing cost

C. Miscellaneous direct expenses

D. Indirect engineering expenses

E. Expenses of distribution, servicing and administration

F. Guarantee expenses

(b) Within . . . . . days after the completion of the production of . . . . . % of the items called for under this contract, the Contractor shall submit to the Contracting Officer a statement of the actual cost of the production of said percentage, itemized in the same way as the estimated cost stated above. Such statement shall be based upon the cost accounting system regularly utilized by the Contractor and certified as correct by an independent public accountant or by two officers of the Contractor. The Contractor shall submit his books and accounts to such examination and audit as shall be requested by the Contracting Officer.

(c) Upon the written request of either party, which request shall be made within . . . . . days after the filing of the statement required by paragraph (b) hereof, the Contracting Officer and the Contractor will enter into negotiations and will attempt to agree upon a modification of the contract.

(d) Pending the renegotiation of the price hereunder, all items delivered shall be paid for at the price set forth in Article 1. Upon the renegotiation of the price hereunder, an amount equal to

<sup>2</sup> State separately the estimated amount of each of the following items included:

- (a) Normal depreciation.
- (b) Special amortization.

the difference between the price paid on all items theretofore delivered and such renegotiated price for such items, if in the Government's favor, shall be applied by the Contractor as a credit against payment for subsequent deliveries, or shall be applied or returned to the Government as directed by the Contracting Officer; if in the Contractor's favor, it shall be paid by the Government on a separate invoice or voucher.

(e) If this contract contains an escalator clause (Price Adjustment) the figures set forth therein and the terms thereof shall be controlling in the absence of a modification of the contract under this article. In the event of such a modification, the escalator clause shall be so modified as to relate only to that portion of the production under the contract which is not covered by the statement of actual cost required by paragraph (b) of this article. In modifying the provisions of the escalator clause, the month in which the renegotiation occurs shall be taken as the base month, and the estimated labor costs and the estimated material costs shall include only such costs as are not reflected in the actual cost statement submitted under paragraph (b) hereof.

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#### EXHIBIT I.

#### JOINT RESOLUTION TO PROVIDE FOR THE RENEGOTIATION OF CONTRACTS FOR THE PRODUCTION OF WAR MATERIALS FOR THE PURPOSE OF LIMITING PROFITS THEREUNDER

Whereas it is imperative that effective measures be taken to limit the profits paid to contractors obtaining contracts for the production of war materials; therefore, be it

Resolved by the Senate and the House of Representatives of the United States, in Congress assembled, That—

1. The Secretary of War is directed to insert in any contract hereafter made by the War Department, which, in his judgment, may result in an excessive profit to the contractor, a provision for the renegotiation of the contract price at a period when the profits can be determined with reasonable certainty.
2. The Secretary of War is directed, whenever in his opinion

excessive profits have been realized, or are likely to be realized, from any contract with the War Department to require such contractor to renegotiate the contract price. This provision shall be applicable to all contracts hereafter made and to all contracts heretofore made, whether or not such contracts contain a renegotiation clause, provided that final payment has not already been made pursuant to such contract.

3. In renegotiating a contract price the Secretary of War shall not make allowance for any salaries, bonuses, or other compensation paid by the contractor to its officers or employees, in excess of a reasonable amount, nor shall he make allowance for any excessive reserves set up by the contractor, and the Secretary of War shall freely use the powers of audit conferred upon him by existing law for the purpose of ascertaining whether such unreasonable compensation has been or is being paid, or whether such excessive reserves have been set up.

4. In addition to the powers conferred by existing law, the Secretary of War shall have the right to demand of any contractor who holds uncompleted contracts with the United States for the production of war materials in the aggregate amount of \$500,000 or more statements of actual costs of production and such other financial statements, at such times and in such form and detail as the Secretary of War may require.

5. The authority and discretion herein conferred upon the Secretary of War may be by him delegated to such individuals or agencies in the War Department as he may designate and he may authorize such individuals to make further delegations of such authority and discretion.

6. The foregoing provisions shall be applicable to the Secretary of the Navy in the case of contracts with the Navy Department, and to the Chairman of the Maritime Commission in case of contracts with that Commission. The powers conferred by paragraph 4 above shall be exercised by the War Department, the Navy Department, or the Maritime Commission, whichever holds the largest aggregate amount of uncompleted contracts for the production of war materials.

## AFFIDAVIT OF H. STRUVE HENSEL

CITY OF WASHINGTON,

DISTRICT OF COLUMBIA, SS:

H. Struve Hensel, being first duly sworn, deposes and says:

1. I have been assistant secretary of the Navy since January 30, 1945. The secretary of the Navy has delegated to me, as assistant secretary, the general supervision over all of the procurement activities of the Department of the Navy. I was appointed a special assistant to the under secretary of the Navy in January, 1941 and was appointed chief of the Procurement Legal Division upon the formation of that Division in July, 1941. When the name of the Procurement Legal Division was changed to the Office of the General Counsel for the Department of the Navy in August, 1944, I was appointed general counsel, which position I held until my appointment as assistant secretary. As chief of the Procurement Legal Division and General Counsel, I had general supervision over all of the procurement legal matters in the Department of the Navy and supervised the drafting of Navy contracts.

2. The statements made in this affidavit are based upon information received by me in my official capacity and which I believe to be true and accurate.

### I. SCOPE AND COMPLEXITY OF NAVY PROCUREMENT.

3. The armed services in December, 1941 were faced with procurement problems on a scale beyond anything which they had theretofore experienced. The problems of allocating materials and manpower were enormous. The Army and Navy urgently needed ships, planes, tanks and other munitions of every kind, regardless of cost. The logistics requirements had changed so much and so swiftly with the outbreak of war that the available data on the Government's previous procurement were of very little assistance in fixing prices which would closely reflect the ultimate costs.

4. Prior to the emergency period, all Navy contracts were let as the result of competitive bidding. The first step away from this



requirement was taken in the Act of April 25, 1939, when the Congress authorized construction of naval facilities on island bases on a cost-plus-a-fixed-fee basis. In the next fifteen months several further authorizations were enacted allowing the negotiation of cost-plus-a-fixed-fee contracts for construction.

5. The first major expansion in the Navy's war-procurement planning was in June, 1940. Upon the fall of France and the Low Countries, the Congress voted to make substantial additions to the United States Fleet. By December, 1941, Navy procurement programs had been accelerated as demands from the Fleet became more imperative. After December 7, 1941, the procurement tempo skyrocketed. So many different items were needed in such large quantities, by both the War and Navy Departments, that the Navy Department felt compelled to give a commitment to almost any manufacturer who demonstrated ability to perform the work.

6. In June and July, 1940, the authorized strength of the Navy was approximately doubled. The "11 per cent Expansion Act" of June 14, 1940 and the "70 per cent Expansion Act" of July 19, 1940 (the Two-Ocean Navy Act) were passed in recognition of the threats to this nation's security implicit in the German victories. These authorizations of increased Navy strength were accompanied by grants of contract authority and the necessary appropriations. The Act of June 28, 1940 (Public No. 671, 76th Congress) granted limited authority to negotiate contracts for vessels, propulsion machinery and equipment, and also granted the necessary authority to construct facilities to build the vessels and munitions. Requests to the Congress for authority to negotiate contracts had emphasized that the Navy had need for utilizing the services of all shipbuilders, all manufacturers of naval ordnance and other munitions, rather than the services of only those making the lowest bids. In point of fact, the contracts let by the Bureau of Ships in late 1940 and the first half of 1941 to carry out the additions to the Fleet authorized by the Congress, in large part tied up the existing naval shipbuilding capacity of the nation. Although new shipbuilding facilities were being constructed and

completed throughout the last half of 1940 and 1941, it was not until early 1942 that the completion of vessels on the ways and the availability of the new shipbuilding facilities made possible the execution of another large group of shipbuilding contracts.

7. The vastness of the procurement programs in 1941 and the early part of 1942, as compared with earlier programs, tended to subordinate all other considerations to the single factor of getting the munitions. The Navy did not during this period have any mechanisms for determining close contract prices or for controlling profits under its contracts. More important, neither the Navy personnel responsible for procurement nor the contractors had any experience to enable them to gauge profits accurately. Many contractors were making new items which had never before been manufactured in this country. Manpower problems began to be acute with the acceleration of inductions under the Selective Service Act. No one had any idea as to what effect manufacture of ordnance and other items by the thousands instead of by single items or in small lots would have on profits. It proved generally impossible to make allowance in advance for increased efficiency gained from experience, and the greater profits, resulting from increased volume. In instance after instance the Navy found that costs and profits seemingly reasonable at the start of the contract became unreasonable after volume and experience had increased. The important contracts were so large that a small margin of error in computing prices could wipe out the contractor's capital. Conversely, allowances for contingencies, intended only for protection, often turned into unexpected profits. Finally, Navy personnel during this period were more interested in getting the munitions than in limiting profits under the contracts for such munitions.

#### a. Contract Statistics.

8. The scope of the problem of acquiring naval supplies and equipment at reasonable prices can be discovered by examination of some Navy statistics for this period.

## i. Commitments and expenditures.

9. For the calendar years 1940-1944, the Navy's commitments and expenditures of appropriated funds were as follows (in billions of dollars):

	Fiscal, 1940	Fiscal, 1941		Fiscal, 1942		Fiscal, 1943		Fiscal, 1944	
	7-1-39 to 6-30-40	7-1 to 12-31-40	1-1 to 6-30-41	7-1 to 12-31-41	1-1 to 6-30-42	7-1 to 12-31-42	1-1 to 6-30-43	7-1 to 12-31-43	1-1 to 6-30-44
Commitments	\$1.1	8.5	4.2	6.0	17.2	13.8	13.0	12.2	12.0
Expenditures		0.9	1.7	2.8	6.2	7.6	13.8	12.2	14.9

The commitments represent roughly the amount of contract obligations (including letters of intent) executed; plus amounts for pay, subsistence and transportation of naval personnel (for the fiscal years 1941 to 1944, inclusive, expenditures for these purposes in billions of dollars, were 0.32, 0.65, 2.01 and 4.8, respectively). It will be noted that commitments in the first half of 1942 almost tripled those of the latter half of 1941, and that expenditures in the first part of 1942 were more than double those of the earlier period. Furthermore, both commitments and expenditures for the second half of 1941 had gone up very considerably over those of the first half of 1941.

## ii. Number and size of contracts.

10. The following figures indicate the vast increase in procurement contracts during the months of the fiscal year 1942 beginning July 1, 1941 up through April 30, 1942. The figures include all new work awarded, consisting of all new contracts, letters of intent and extensions of existing contracts. Letters of intent were the informal (but nonetheless binding) contracts awarded to a manufacturer in order to authorize him to get started on the work in advance of the time when detailed contract terms or prices could be worked out. They were often used when specifications were not completed, when it was necessary to finance the contractor immediately, or when the detailed terms—including often intricate payment provisions and delivery schedules—might take a long time to negotiate.

# Affidavit of H. S. Hensel.

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(\$1,000,000's)

	1941						1942			
	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.
Total dollar amount of awards	\$662.8	\$42.1	565.6	414.1	487.1	1,026.3	1,372.9	2,927.5	2,202.9	1,953.8
Expenditures				\$450	400	700	600	700	1,100	1,200
Total number of awards over \$50,000	541	473	434	587	604	749	1,083	1,085	1,344	1,727

11. The above figures are further broken down by Bureaus as follows:

(\$1,000,000's)

	1941						1942			
	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.
NOd contracts (signed by Secretary—primarily facilities, vessels)										
\$ Amount	\$73.6	40.0	121.8	79.9	4.9	50.0	37.9	6.3	10.1	33.7
No. over \$50,000	32	31	40	26	7	23	21	15	15	38
NOrd Contracts (BuOrd)										
\$ Amount	\$12.3	23.7	13.2	11.0	61.5	27.2	58.7	35.9	99.4	138.4
No. over \$50,000	8	9	8	22	36	26	25	27	70	87
Nos, NXs Contracts (BuSand A)										
\$ Amount	\$306.3	247.2	372.8	228.7	281.8	724.0	747.7	2,344.4	1,254.5	1,135.5
No. over \$50,000	351	340	318	404	362	477	670	657	735	1,070
NOy Contracts (BuY & D)										
\$ Amount	\$264.4	25.9	55.4	100.3	110.4	101.4	143.4	145.1	184.2	331.5
No. over \$50,000	128	66	80	120	167	180	230	251	380	326
NObs Contracts (BuShips)										
\$ Amount				\$0.9	5.5	119.5	361.7	315.8	628.4	230.8
No. over \$50,000				2	15	26	61	78	96	116
NOa Contracts (BuAero—only facilities)										
\$ Amount					\$21.6	2.9	5.4	71.3	21.0	66.1
No. over \$50,000					11	4	14	20	27	26
NOm Contracts (Marine Corps)										
\$ Amount	\$6.2	5.4	2.4	2.2	1.6	4.3	18.2	8.7	5.1	9.4
No. over \$50,000	22	27	8	13	6	13	36	37	21	55

Throughout this ten-months' period, the Bureau of Supplies and Accounts executed all contracts for the articles specified by the Bureau of Aeronautics (except facilities) and for a great many of the articles specified by the other Bureaus. In September and October, 1941, the Secretary delegated his power to execute negotiated contracts to the Chiefs of the several Bureaus; this fact accounts for the change in distribution of the contracts awarded following such months.



## iii. Decline in use of competitive bids.

12. The following table shows the predominance of the negotiated contract as compared with contracts let after competitive bids during the period in question:

	(\$1,000,000's)											
	1941						1942					
	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.		
Competitive bids	\$96.9	78.4	88.9	87.5	101.1	121.8	112.1	73.7	67.9	107.2		
Negotiated contracts (including letters of intent and extensions of existing contracts)	\$505.1	250.0	457.1	311.4	362.0	869.2	1,222.6	2,803.2	2,112.6	1,835.3		

Under the old competitive bid contract, used prior to the emergency, there was almost no pricing problem—the contract was awarded to the lowest bidder. It is true that a modified system of competitive bids was used in the award of many negotiated contracts; the Department would request several manufacturers to submit, more or less informally, their estimated prices. The manufacturer submitting the low price would, other conditions being equal, receive the bulk of the Department's order for the item to be procured. In many cases, the Department would negotiate contracts with all of the manufacturers submitting prices; the high bidders would receive contracts for lesser quantities than the low bidders. Under this modified form of bidding, however, there was some negotiation in the arrival at the final contract price, and pricing was much more of a problem than it had been under the earlier system of competitive bidding.

## iv. Dollar amount of letters of intent.

13. The progressive increase in the use of letters of intent indicates the pressure which was being put upon contracting officers. The following table demonstrates the increasing reliance upon letters of intent:

	(\$1,000,000's)											
	1941						1942					
	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	March	April		
Total contracts awarded	\$662.8	342.1	565.6	414.1	487.1	1,026.3	1,372.9	2,927.5	2,202.9	1,953.3		
Letters of intent	\$124.9	20.6	80.1	33.0	23.1	249.6	628.8	2,408.6	1,416.5	860.7		
Previous months' letters of intent superseded by contracts executed					\$48.2	57.6	26.1	53.7	223.7	297.9		

The use of letters of intent in the Bureau of Ships is particularly striking:

**Bureau of Ships—Contracts Awarded**  
**(\$1,000,000's)**

	1941, Dec.	Jan.	Feb.	1942 Mar.	Apr.
Total contracts awarded .....	\$119.4	361.7	315.7	628.4	236.8
Letters of intent .....	\$119.4	361.7	313.5	628.4	225.8
Previous months' letters of intent superseded by contracts .....	\$0.3		6.1		

14. In conclusion, the contract figures for the fiscal year 1942, from July, 1941 until the passage of the renegotiation statute, show (1) a great increase in the amount of material contracted for, (2) virtual abandonment of competitive bidding as a method of awarding contracts and (3) an increasing use of the letter of intent.

**b. General Factors Making Close Prices Difficult.**

15. A number of factors complicated the procurement programs at this time. These factors were more or less inevitable with the outbreak of war and the huge spurt in procurement.

**i. Lack of experience.**

16. The enormous increase in procurement tells its own story. The Navy Department had no experience enabling it to cope with the problem of fixing close prices under the new procurement programs. Contractors were being asked to produce items in quantities never before contemplated. Thus, in late 1940 and early 1941, contracts for vessels were let in quantities exceeding those of the first World War, and in early 1942, these quantities were still again increased. A single contract for one ordnance item (5" gun mounts) which had theretofore not been made outside Government gun factories, called for a quantity of such items in excess of the total number previously made in this country in the gun factories. Many other examples could be cited.

17. Contractors were called upon to manufacture new items which had never before been produced—such items as radar equipment, new plane and vessel designs, floating drydocks, and Bofors and Oerlikon guns. Specifications for some items were not com-

pleted until the contract was performed; the requirements for other items were changed constantly through the life of the contract.

18. Many contracts were long-term contracts which extended for more than one year. The majority in dollar volume of combatant ship contracts were contracts for twelve months or more. Similarly, most of the contracts for construction of public works and facilities, and for air frames and engines were long-term contracts. The bulk in dollar amount of contracts let for these items in the fiscal year 1942, prior to passage of the renegotiation statute, ran until 1942 or 1943. Almost all aircraft and construction contracts were let on a cost-plus-a-fixed-fee basis. Of the contracts for vessels, a larger dollar amount were made on the fixed-price basis, but these fixed-price contracts were made subject to adjustment and escalation in respect of direct labor and material costs.

19. Contracts were awarded to many contractors, particularly in the aircraft industry, in amounts tens and even hundreds of times greater than their capital investments.

ii. Problems in building up procurement personnel and organization.

20. For the fiscal year 1940, obligations of Navy appropriated funds totalled approximately 1.1 billion dollars; for the fiscal year 1941, obligations were about 12.7 billion dollars (note the table in paragraph 9 above). In fiscal 1942 total obligations were 23.2 billion dollars, with obligations in the second half of such fiscal year (*i.e.*, the first half of calendar 1942) amounting to 17.2 billion. The dollar volume of obligations incurred in the first six months of 1942 was comparable to the dollar volume of obligations incurred in the preceding two and one-half years (2.8 billion dollars less). The great jump in contract obligations which took place in the second half of 1940 was largely due to the great expansion in shipbuilding authorized in mid-1940, and, to a somewhat lesser extent, to the expansion in plane authorizations and construction of public works and facilities.

21. Within two years, the procurement machinery of the Navy

had to be stepped up to the point where it could turn out, in a six-months' period, contracts for munitions for about thirty-one times the dollar amount of the obligations incurred in the first half of 1940 (approximately \$0.55 billion—50 per cent of the \$1.1 billion commitments recorded for the twelve months of fiscal 1940—as compared with \$17.2 billion in the first six months of 1942). The difficulties of turning out the contracts for the widely diversified items procured by the Navy (from battleships to buttons, from planes to pork products) increased rather in a geometric progression as the dollar amount of Navy needs and the number of Navy contracts necessary to fulfill such needs multiplied.

22. The Navy Department started its emergency procurement program in June, 1940, with personnel adequate to handle one billion dollars of procurement per year; it was impossible, within the year and one-half which followed, to build up the personnel who could handle procurement at the rate of 34 billion dollars per year (17.2 billion dollars for the first half of 1942), and at the same time achieve close pricing on the munitions for which contracts were being written. Even if there were in the country enough persons skilled in procurement problems and analysis of costs to undertake to fix close prices on munitions, such persons would have had no background of experience in the prices of a large proportion (if not most in dollar volume) of the items procured by the Navy. Not only was the Navy Department purchasing many items which had never before been made by the contractors, but it was also purchasing items in such quantities in 1941 and early 1942 that previous price experience was almost useless as a guide.

23. It is most important to recognize that pricing was only one of the factors which had to be considered by the Navy Department in expanding its procurement. The enormous increase in the number of technical personnel—engineers, architects, designers—required to handle the specifications for Naval material can be understood readily enough. Another factor too often overlooked is the mechanical problem of getting out com-



pleted contracts. The Bureaus, which prepared all of the contracts, had to set up entirely new contract organizations. The coordination of procurement by the Bureaus became increasingly difficult—what had been relatively simple when procurement was at the rate of one billion dollars a year became extremely complex when procurement jumped twelvefold, and then twenty-three fold. Many different efforts at coordination were made; the agencies most responsible for unifying contract policies—the Procurement legal division of the under secretary's office and the office of procurement and material of the secretary's office—were not established until July, 1941 and January, 1942, respectively. Organizations to assist contractors—in obtaining priorities, solving labor problems, building facilities, securing capital—all had to be established and manned, and it took time for such organizations to acquire the necessary know-how. Other organizations were required to coordinate Navy procurement policies and procedures with the policies and procedures of other Government agencies, to prevent the competition for contractors which helped to demoralize the early procurement of World War I.

24. The Navy Department had made a fair beginning towards solving these many problems at the time war was declared. The declaration of war, however, at the same time rendered imperative the immediate functioning of all of the agencies necessary to handle the procurement problems, and also made the problems much more acute. Through all of the process of organization for wartime procurement, the contracts had to be turned out, and in far vaster quantities than theretofore. One partial solution, of course, was the issuance of letters of intent rather than the more formal contracts, which could be worked out thereafter. The figures which I have cited earlier indicate the extent to which this device was used in the period under consideration. The use of letters of intent, however, merely postponed the day when the more formal contract was to be written; and at several times the backlog of letters of intent became perilously large. And the problem of pricing still remained when letters of intent were used. The Department did issue some letters

of intent under which prices were fixed, but as a general rule, the letters of intent were silent as to prices, with the understanding that prices would be set later in the definitive contract.

25. The Navy Department was struggling, throughout the year and one-half prior to passage of the renegotiation statute, to obtain personnel to get out the specifications, to write the contracts, and to aid in the production, of the material required. Indeed, we have not today completely solved this problem—we still have need of experienced personnel who can take over the constantly changing procurement problems.

iii. Uncertainties as to costs.

26. Added to the absolute lack of experience as to the cost of many items and the difficulties inherent in training personnel to meet new problems of theretofore unrivalled magnitude, were the many uncertainties as to certain costs—in 1941 and 1942 the scarcity of materials and of manpower, and rising prices and wages, made particularly difficult the forecasting of costs.

27. The problem of material shortages became acute in early 1942. The predecessor to the War Production Board had been established to administer the priorities authorized by the "Navy Speed-Up Act" of June 28, 1940. The Army and Navy Munitions Board had been working with the War Production Board and its predecessors for the one and three-quarter years prior to April, 1942, in enforcing a system of priorities in metals for Government contracts. In the first half of 1942 the armed services and the War Production Board were engaged in working out a system of control much stricter than that theretofore in effect—the Production Requirements Plan, which was put into effect on July 1, 1942. The application of all of the priority ratings was an immensely complicated job, which was administered in the Navy Department by the Production Branch of the Office of Procurement and Material. In addition to the metals covered by the priority schedules, there were several other raw materials which were at this time extremely critical because of shipping losses and other factors.

28. At this same time also, manpower shortages were beginning

to be felt as the draft was stepped up enormously, although the shortage in manpower became most critical some months later.

29. The armed services had experienced some labor and wage troubles at the plants of contractors. The most acute cases were, of course, those of North American Aviation, Inc., which was taken over by the War Department under Executive Order No. 8773 dated June 9, 1941, and Federal Shipbuilding & Dry Dock Co., which was taken over by the Navy Department under Executive Order No. 8868, dated August 23, 1941. Wages were rising, from early 1941 onward. In mid-1941, the Navy took the initiative in having the nation's shipbuilders enter into zone agreements with respect to labor. These agreements, while they helped to insure a supply of labor, had the undoubted effect of raising labor costs at most shipyards, including those not covered by the agreements, which tended to raise wages for all shipyard workers. There was also established a shipbuilding stabilization program reimbursement policy, to which the Navy Department, War Department and Maritime Commission adhered; the three agencies have from time to time issued administrative instructions governing reimbursement to shipbuilders of specific labor costs. Zone agreements somewhat similar to those in the shipbuilding industry were likewise established for the construction and building-trades industries.

30. Wages continued to rise throughout late 1941 and the first part of 1942, and the trend was not effectively checked until after the president's "hold-the-line" Executive Order 9250 (promulgated upon passage of the Second Emergency Price Control Act of 1942 on October 2, 1942) which empowered the president to establish wage ceilings. Overtime charges began to mount in late 1941. As the War and Navy Departments demanded speeded-up production and extra shifts, they promised fixed-price contractors, who had not contemplated substantial overtime wages at the time their contracts were let, that the contract prices would be adjusted in the light of the overtime payments.

31. Scarcity of materials and growing scarcity of manpower made for higher costs to contractors. From the very inception of

the national defense program, contractors were fearful of price rises which might wipe out not only their profits under long-term contracts, but also their entire companies. They were therefore insistent upon protection by the Government against such price rises. From the latter part of 1940 on, escalator clauses were demanded with increasing frequency under fixed-price contracts. In 1941 and early 1942, I should judge that the great majority in dollar amount of fixed-price contracts provided escalation in some form or another. Many contractors faced with the production uncertainties which I have outlined above, in addition to price increases, insisted upon cost-plus-a-fixed-fee contracts to protect themselves.

32. Increases in production and in efficiency were so swift that in many cases the increased costs which had been anticipated and were to be covered by escalation were completely swallowed up in the greater than anticipated profits earned by contractors. It had been, and still is, generally impossible to forecast accurately the effects upon costs, of increased volume or of the productive efficiency of Navy contractors. In addition to this fact that contingent costs (against which escalation was provided) were offset by unanticipated profits, the fixed price under any contract containing an escalator clause invariably also contained allowances for many contingencies not covered by escalation. Escalator clauses did not provide complete protection against fluctuation in costs; there were at the time many uncertainties as to overhead costs against which the contractor claimed to have no protection except amounts for contingencies included in his contract price. In practice, price escalation worked only upwards, although the escalator clause generally did provide for revision downwards of prices based on direct labor and material costs, as well as for revision upwards thereof. The cost-plus-a-fixed-fee contract was virtually a riskless contract. As the production of so many contractors increased many times over, the return in profits under fees fixed upon the volume of their business amounted to vastly more on their capitalization than had profits prior to the emergency and war periods.

33. Manufacturers demanded protection against the uncertain-



ties facing them; the Navy Department, which had no means of forecasting costs, of necessity had to provide the protection in its contracts in order to obtain the munitions. In general, Navy contractors in 1941 and early 1942 were including in their fixed-price or estimated cost (under cost-plus-a-fixed-fee contracts) allowances for almost all contingencies which could conceivably happen. Almost never did more than a portion of such contingencies happen with respect to a single contractor. In addition, production techniques improved so much more rapidly than expected with respect to a great many items that actual costs in quantity procurement were far lower than those which might reasonably have been expected.

iv. Navy contracting and pricing personnel.

34. As the statistics earlier cited make clear, most of the increased procurement from mid-1940 to April, 1942 (and to date) has been accomplished under negotiated contracts. A very substantial proportion of these contracts were cost-plus-a-fixed-fee contracts, including almost all construction contracts and plane contracts; all facilities contracts provided for reimbursement of costs to the contractor. With respect to the fixed-price negotiated contracts, it was necessary to negotiate prices with the contractors on the basis of estimated costs. The cost of performance was to the extent possible based upon past experience, but past costs were generally stepped up by the inclusion of allowances covering the many uncertainties facing the contractor. The contractor would not undertake the work without adequate protection—and the Navy Department had no valid argument, in the light of the uncertainties as to costs facing the contractor, for rejecting allowances for the protection of the contractor. There was always the possibility, of course, that not all of the contingencies against which protection was being provided in the price would occur, but no one in the Navy Department or anywhere else was able to forecast what contingencies would occur and what ones would not. It is true that many of the fixed-price contracts provided escalation for certain costs, but the inclusion of escalation was

necessary in such cases to provide the further cushion without which the contractor would not undertake to risk the hazards inherent in a fixed price.

35. Prices under contracts awarded after competitive bids were of little aid in determining prices for similar items under negotiated fixed-price contracts. Bidders for Navy contracts submitted bids on the basis of comparative prices and of what they anticipated would be the lowest price, rather than on any very close analysis of costs. In any event, the quantities specified in these earlier contracts and the conditions under which they were let did not afford any precedent for pricing in the later period. With the advent of the negotiated contract, more and more of the nation's industrial capacity was converted to Government work. Competitive forces ceased to have any bearing upon prices—in practical effect, all contracts let were based upon crude estimates of costs, however faulty the early estimates might be, plus an additum for contingencies and profit. As the House Naval Affairs Committee discovered, prices under negotiated contracts were generally lower than prices for comparable items under contracts let to the lowest bidder.

36. At the beginning of the emergency period (June, 1940), the outlook of the Bureaus relative to prices was slanted almost entirely toward purchasing on the competitive bid basis. The Bureau of Supplies and Accounts continued to award some contracts during this period of early 1942 on the basis of competitive bids. Several of the Bureaus had personnel who dealt with comparative prices, based on past experience; such personnel sought to work out prices with contractors. The Bureau of Supplies and Accounts, which had been purchasing standard items in quantity for years, did have some comparative data on prices, based on the competitive bid awards. But, as procurement vaulted to quantities many times the quantities purchased before the war, this data became increasingly obsolete. It was true that the Stock, Schedule and Statistical Sections of the Bureau kept records of past purchases and that such records would be of value in ascertaining the propriety of a negotiated fixed-price. The other Bureaus had only a handful of per-

sonnel engaged in drafting of contracts and pricing thereunder, and began in the latter part of 1940 to build up their contract divisions.

37. The new contracting personnel necessary to handle the increased volume of procurement, gradually gained experience with pricing; their training took time. At the start of the emergency procurement, there was on hand inadequate data as to contractors' costs, and consideration of prices offered by contractors was based largely on comparison with prices paid by the Navy for similar munitions in the past, usually under very different conditions. Past experience naturally offered little guide in the determination of prices to be paid for articles which had never been built before, as we discovered in the cases of destroyer-escorts and anti-aircraft guns, for example.

38. As of April 28, 1942 the Navy Department did not have any working organization whose primary responsibilities were analysis of prices and advice in the negotiation of accurate prices which when compared with costs would not allow undue profits. The Cost Analysis Section and the Price Adjustment Board had just been established in the Office of Procurement and Material (itself organized on January 30, 1942) attached to the secretary's office, and had had little opportunity to accomplish anything in the way of recommending price reductions. There was no agency—and would not be until July or August, 1942, when the Price Negotiation Branch of Supplies and Accounts was set up—which was in negotiating a procurement deal solely responsible for checking into the contractor's probable costs and for seeking to determine whether the prices submitted should be reduced. A lot of thought had gone into the matter of high prices, and excessive profits, and we were slowly moving toward corrective measures which proved to be effective. It is true that before the war, almost half in dollar amount of negotiated contracts were let on a cost-plus-a-fixed-fee basis, or on a cost basis in the case of facilities, and a substantial portion of contracts were still being made to the lowest bidder after solicitation of competitive bids. Past experience was of little assistance in the latter case. Most of the large profits

earned by Navy contractors were due to increased volume or ability of the contractor, making a new article with which he was unfamiliar, to reduce his costs promptly, and to allowances for contingencies which did not arise. The Navy Department did not have the pricing experience at this time to deal adequately with these factors. Again I want to point out quite frankly that the Department was primarily interested in getting the munitions as promptly as possible. In the haste to acquire the material of war, it had also to expand and develop its procurement organization. The Navy Department had at the time neither the knowledge nor the experienced personnel necessary to achieve close pricing—and indeed, during wartime, it may be doubted whether anything but limited success in negotiating prices to reflect costs can be achieved.

c. Specific Contract Prices During This Period (July, 1941–April, 1942).

39. Naturally, as contractors gained experience, and as the Navy became better able to analyze costs, it has been possible to negotiate lower prices on a great many items. I have listed some of the factors which made for high prices and high profits. I submit some actual examples of prices under contracts let during this period and subsequent reductions of these prices.

i. Bureau of Ships.

40. The Bureau of Ships was responsible in 1941 and 1942 for the expenditure of a larger dollar volume of appropriations than was any other Bureau (although the Bureau of Supplies and Accounts in the months prior to passage of the renegotiation statute was writing a larger dollar volume of contracts, because of the large number of contracts such Bureau wrote upon requisition from the other Bureaus). The value of ships completed and converted under Navy contracts rose from about \$142,146,000 in the second half of 1940, to \$720,494,000 in the first half of 1942, to \$3,590,509,000 in the first half of 1944. For the fiscal year 1941 (July 1, 1940–June 30, 1941), expenditures by the Bureau of Ships totaled \$912,000,000, as compared with \$3,074,000,000 for the next fiscal



year, and \$9,384,000,000 for the fiscal year 1944 (June, 1944, estimated).

41. The contracts necessary to fulfill the 11 per cent and 70 per cent expansions of the Navy (authorized by the Congress in June and July, 1940) were largely awarded by the end of the first quarter of 1941. In general, these contracts, which each specified the delivery of a number of combatant ships, were not completed until the latter part of 1942 and 1943. On the average, the following lengths of time are required to complete the several combatant ships:

Battleships .....	32 to 35 months.
Aircraft carriers .....	17 to 21 months. (The escort carriers require about 11 months.)
Cruisers .....	22 to 25 months.
Destroyers .....	7 to 13 months.
Destroyer Escorts .....	7 months.
Submarines .....	11 months.

42. I have had compiled data on some 13 contracts executed between July, 1940 and February, 1941, covering combatant ships. These contracts, all of which were made on a fixed-price basis, subject to adjustment according to changes in direct labor and material costs, provided a total of \$750,097,400 (before adjustment) of contract prices. None of these contracts was completed until late 1942 or 1943. They were completed at a total cost to the contractors of \$514,720,566. The total profit under the contracts, disregarding adjustments and disregarding renegotiation and voluntary refunds, would therefore have amounted to \$235,376,834, or 45.7 per cent of the cost of performance. The cost of performance included increases in labor and material prices during the lives of the contracts, whereas the contract prices as above stated have not been adjusted upward in accordance with escalator adjustments to which the contractors would have been entitled under their contracts. Since the basic month for escalator purposes was between July, 1940 and February, 1941, and the expenditures were incurred from one to two years later, sharp up-

ward adjustments would have been required if escalation had been computed—it is estimated that such adjustments would have amounted to 10 to 15 per cent of the cost in the case of destroyers, and 15 to 20 per cent of the cost in the case of the larger vessels. As examples of the discrepancies between original unit contract prices and unit costs to the contractor under these contracts, I cite the following:

	Number of Ships	Original Unit Price	Average Unit Cost Destroyer Program	Difference as Percent- age of Costs
1st contract	6	\$7,159,700	\$5,445,225	31.5
2nd contract	6	6,813,200	4,560,074	49.5
3rd contract	8	5,379,000	4,705,896	14.3
4th contract	5	7,360,000	4,900,245	50.2
5th contract	17	6,813,000	4,425,605	53.9
6th contract	6	5,977,000	4,241,268	40.9
7th contract	4	5,579,000	4,620,142	20.8
Carrier Program				
1st contract	2	43,662,000	26,625,000	64.0
2nd contract	1	42,725,000	26,500,000	70.6
3rd contract	3	46,125,000	26,600,000	73.4
Cruiser Program				
	2	19,272,500	14,725,000	30.9
Submarine Program				
1st contract	13	2,795,000	2,246,761	24.4
2nd contract	25	2,765,000	2,246,761	23.1

At the time of the award of the above contracts, there was an informal understanding between the Bureau of Ships and the contractors that if actual costs proved to be out of line with the prices fixed, some adjustments would be made. In practice, since none of these contracts was completed until after the passage of the renegotiation statute, all were renegotiated under the statute.

43. Both the destroyer-escort program and the landing-craft program were launched in force in early 1942, although the great majority of contracts for these vessels were not executed until after

passage of the renegotiation statute. In neither case had the contractors or the Navy Department had any experience with building these new types of vessels, and original costs were naturally high, because specifications were constantly changing on the early vessels. No contracts for destroyer-escorts were made prior to passage of the renegotiation statute. Work had been begun, however, on several of the vessels, and general agreement on an estimated cost of \$3,300,000 per vessel was reached in the first part of 1942. All of the contracts for these ships except one was made on a cost-plus-a-fixed-fee basis, and the resulting actual costs of the ships indicate the difficulty of arriving at a fair estimate for an item which has never been made before. Actual costs under eight contracts varied from \$1,440,198 per vessel to \$2,667,583 per vessel (the next highest being \$2,348,578). The total fees fixed on the eight contracts amounted to 11.87 per cent of the actual cost. Under the single fixed-price contract, which provided a unit price of \$3,500,000, actual unit costs amounted to \$1,809,644, or a profit without renegotiation of 93.4 per cent. As I have earlier indicated, the contractor who took work on a fixed-price basis was entitled to cushions for the many contingencies which might arise and wipe out his profits. There was a definite agreement with respect to the destroyer-escort contracts that as costs were more accurately determined, prices and estimated costs would be adjusted accordingly. The Navy Department was in no position to insist upon the elimination of cushions from the price of a ship which had never before been built, with all of the uncertainties as to costs facing the contractor.

44. With respect to propulsion machinery, I shall repeat an example which was submitted by Secretary Knox to the Congress in April, 1942.<sup>1</sup> Secretary Knox said:

For example, one of our suppliers with whom we had a contract for 200 destroyer turbines produced the first turbine on our designs at a cost of \$2,559,000, which was very sub-

<sup>1</sup> Hearings before the House Naval Affairs Committee on H. R. 6790, 77th Cong., 2d Sess., April 16, 1942, page 2922.

stantially above what that company's engineers had estimated the cost would be. After the production of 15 turbines, through economies of operation and increased efficiency, this cost was reduced to \$607,000 per turbine. It is now estimated by the company that it will not be until after completion of the seventy-second turbine that the cost will drop to the figure estimated in quoting to the Navy the contract price of \$300,000 per turbine. This latter cost the company believes will be stable.

ii. Bureau of Ordnance.

45. During this period in question, a very large amount of ordnance items were procured under contracts made by the Bureau of Supplies and Accounts. Expenditures by the Bureau of Ordnance increased from \$377,000,000 for the fiscal year 1941, to \$1,915,000,000 for the next fiscal year and \$3,634,000,000 for the fiscal year 1944.

46. Typical of the increases in volume of ordnance procurement is the jump in production under Navy contracts of one anti-aircraft gun from approximately 1,000 in the last half of 1941 to about 10,500 in the first half of 1942; another gun jumped from 300 to 1,000 over the same two periods (top production of this item was reached in the second half of 1943 with 3,800 production). Production of Navy ammunition multiplied many times over in 1942.

47. The progressive reductions in prices of two types of anti-aircraft guns which had not prior to the present emergency been manufactured in this country is most striking. These guns have been manufactured for the most part by former automobile manufacturers, who had obviously had no prior experience in their production. The Oerlikon gun (20 mm.) with one type of mount was manufactured under one contract made September 9, 1941 for a price of \$7,531.42 per gun; under a contract dated January 20, 1943 with another manufacturer, its price had been reduced to \$4,519.97, with a still different type of mount; a contract for the



Oerlikon guns dated September 22, 1942 specified a unit price of \$6,330; the later contract with the same manufacturer dated May 5, 1944 had brought the price down to \$3,666. This same type of gun was made without mounts under a contract dated June 8, 1942, fixing a unit price of \$4,958.50; the present contract with the same manufacturer dated May 5, 1944 specifies unit prices ranging from \$2,133 down to \$1,708 as production increases.

48. The Bofors gun (40 mm.) prices show equally astonishing decreases. The original contract dated January 7, 1942 specified a unit price of \$4,288 (without mounts); the later contract with this manufacturer dated November 11, 1943 brought the price down to \$2,510.

49. Prices of 20 mm. and 40 mm. projectiles have come down to about 50 per cent of the original prices. These items are items as to which the changes in specifications have not presented the problem present with respect to many naval munitions. Quantities produced under Navy contracts have multiplied many times over during the past three years, and the price reductions may be attributed in large part to increases in volume. Production of the 20 mm. shells was begun in June, 1941 under eight contracts specifying unit prices which varied between 21.5c and 25.23c per shell; the most recent contracts in January and May of 1944 specify prices from 11.2c to 14.46c per shell. Similarly, production of 40 mm. projectiles began in June and July, 1941 under eight contracts with prices ranging from 64c to 84c per unit; the latest contracts, executed in August and November, 1943 and September, 1944, provide payment of between 43c and 50c per shell.

50. Prices of other ordnance items have indicated how difficult it is to arrive at a price under the original contracts. One model of gunsight has dropped from \$2,638.29 to \$1,571.19. A case for depth charges which originally cost the Government \$15.07 was later reduced to \$10.31. Three-inch gun-barrel forgings were priced at \$1,580 under the original contract of May 5, 1941; under the contract dated November 21, 1942, the price had gone down to \$1,000.

## iii. Bureau of Supplies and Accounts.

51. This Bureau purchases all of the standard supplies, hardware, clothing, subsistence items, and the like. The Bureau both prepares the specifications and writes the contracts for most standard supply items—hand tools, repair materials, furniture, stock items and the like. In 1941 and 1942 the Bureau of Supplies and Accounts also wrote a great many contracts for the other Bureaus, which drew up the specifications for the items to be procured, negotiated the price, and then sent a "requisition" covering the procurement to the Bureau of Supplies and Accounts to be written up in contract form.

52. Total expenditures of the Bureau (for items as to which it both prepared the specifications and wrote the contracts) increased from \$563,000,000 in fiscal 1941 to \$1,409,000,000 in fiscal 1942 and to \$6,127,000,000 in fiscal 1944. These figures include expenditure of very substantial amounts for pay, subsistence and transportation of naval personnel. A very large proportion in dollar amount of the Bureau's total procurement consists of petroleum products.

53. The prices under Navy contracts of most of the subsistence items and clothing items are so closely related to material costs that volume procurement does not have any appreciable effect upon the prices. I do not therefore present any examples of purchases of either subsistence or clothing items.

54. I shall cite several examples of reductions in the prices of some standard stock items largely as a result of purchasing in large quantities. Thus, twist drills are purchased under contracts for hundreds of thousands of dollars; the unit prices for these drills in different sizes and specifications vary from 8 or 10c to several dollars. Prices under a 1944 contract with one manufacturer for assorted lots of drills were  $22\frac{1}{2}$  per cent less than prices under a 1942 contract with the same manufacturer. Another item of hand tools—hand taps—are purchased in a very wide variety of sizes and prices. Prices under a 1944 contract for hand taps show a decrease of 20 per cent under the prices specified in a 1942 contract with the same manufacturer.

55. Comparison of prices for sisal rope of a certain specification under two contracts with the same manufacturer shows the following unit prices:

Size of rope	Price per pound	
	1942 contract	1944 contract
3/4" .....	\$0.195	\$0.1835
1 1/8" .....	.19	.1763
1 1/2" .....	.1825	.1619
4 1/2" .....	.175	.1547
8" .....	.175	.1547

The differences per pound are in cents and fractions of cents; but as the contracts involve several hundreds of thousands of pounds of rope, these differences become quite large in total.

56. The difference is even more substantial in the case of steel cable. One of the early contracts, made in 1941, specified a price for certain 1/8" steel tow cable of \$0.051 per foot; the contract for the same type of cable with the same manufacturer in 1944 provided a price of \$0.037 per foot—a decrease of \$0.014 per foot, or 28 per cent. The later contract required delivery of 30,000,000 feet of cable, so that the total decrease from the original price amounted to \$580,000.

57. Paint brushes under two contracts about 10 months apart (both executed in 1944) with the same manufacturer decreased, from \$2.95 to \$2.61 for one size, from \$2.67 to \$2.34 for another; again, the difference is substantial under a contract for 105,578 brushes.

58. Perhaps a comparison of prices of nuts and bolts under a 1943 contract and a 1944 contract will bring home as cogently as any other comparison the difficulty of close pricing on small standard items. Under the earlier contract, the price for one 1/2" by 5" bolt and nut was \$2.86 per hundred, while the price under the later contract was \$2.12 per hundred; the prices for a 3/4" by 6" bolt and nut were \$7.31 per hundred as compared with \$5.30 per hundred. Even more striking is the difference between the prices for a 1" by 5" bolt and nut—\$14.90 per hundred under the first contract, and \$10.10 under the second.

## iv. Bureau of Aeronautics.

59. All contracts for aircraft and aircraft components during 1941 and 1942 were drafted and executed by the Bureau of Supplies and Accounts, although prices and terms under these contracts were negotiated by the Bureau of Aeronautics. Expenditure of appropriations for which the Bureau of Aeronautics was responsible increased from \$194,000,000 in fiscal 1941 to \$1,052,000,000 in the next fiscal year, and \$4,696,000,000 in fiscal 1944. Total aircraft accepted (reflecting earlier contracts made) increased 122 per cent from the first half of 1941 to the second half of 1941; acceptances in the first half of 1942 were 270 per cent of acceptances in the preceding six months and the second half of 1942 saw acceptances more than 200 per cent of those for the first half of that year.

60. The contracts for airframes during this period were, with one exception, all cost-plus-a-fixed-fee contracts. They were invariably long-term contracts, in general extending over 18 months or more. The airframe manufacturers required cost-plus-a-fixed-fee contracts at this time, for their margin of capital in relation to total business was so small that they could not afford to incur any risks. For example, the Grumman Company had a capital of \$5,000,000, yet its contracts with the Navy approximated half a billion dollars.

61. In the contracts for both airframes and engines, innumerable changes in specifications are made during the life of the contract.

62. One cost-plus-a-fixed-fee contract for torpedo bomber frames was let on March 23, 1942, at an estimated unit cost (plus fee) per plane of \$101,863. This same contract was later converted into a fixed-price contract providing for incentive payments as reductions were made below specified costs, and as of September 30, 1944, the unit redetermined price was \$58,050. A cost-plus-a-fixed-fee contract for scout bomber frames was made on February 2, 1942, at an estimated unit cost (plus fee) of \$34,019 per plane; the present contract for the same frames is on the basis



of \$30,160 estimated unit cost. Finally, a contract made May 23, 1942, on a cost-plus-a-fixed-fee basis provides an estimated unit cost of \$63,985 for fighter frames; the most recent contract for these frames (fixed-price adjusted contract) calls for a unit price of \$39,000.

63. Similar decreases are evident in the procurement of engines and propellers. Prices under 1941 and 1942 contracts for three different types of engines and two types of propellers, and prices under more recent contracts for the same articles may be compared as follows:

	Old Contract			Latest Contract		
	Date	No.	Unit Price	Date	No.	Unit Price
1st Type Engine	9/10/41	204	\$14,500	12/29/43	439	\$11,200
2nd Type Engine	7/29/41	2,293	13,151	12/29/43	400	11,000
3rd Type Engine	7/14/41	80	6,522	12/29/43	1,400	5,800
1st Type Propeller	4/ 4/42	259	1,081	12/23/43	583	800
2nd Type Propeller	3/30/42	248	2,266	12/29/43	3,375	1,800

64. The procurement of aircraft components likewise shows striking reductions in contract prices as the items are produced in greater quantities and as mechanical problems are surmounted. The following table shows the reductions in prices which have been effected for some items:

	Old Contract		Latest Contract	
	Date	Unit Price	Date	Unit Price
Motor Alternator	4/27/42	\$280.00	5/15/44	\$173.00
Starter—1st type	3/ 1/42	370.00	3/ 4/43	333.00
Starter—2nd type	2/ 2/42	355.00	12/ 2/43	290.00
Generator	9/11/41	343.00	7/11/44	229.00
Navigational Watch	5/28/41	30.25	3/23/44	28.45
Oil Pressure Gauge	10/16/41	2.35	11/10/43	1.95
Compass	8/22/40	43.50	4/13/44	35.72

#### v. Bureau of Yards and Docks.

65. The expenditures of the Bureau of Yards and Docks increased from \$412,000,000 in the fiscal year 1941 to \$1,076,000,000 in the fiscal year 1942, and \$2,265,000,000 in fiscal 1943. The Bureau's work reached its peak in the second half of 1942, when some \$1,768,625,000 of work was reported completed on projects under the supervision of the Bureau of Yards and Docks.

The great bulk of this work was done under contracts which had been made prior to passage of the renegotiation statute—indeed, many of them were made in 1939, 1940 and 1941, when some of the large contracts for base projects and advance bases had been let. The Bureau of Yards and Docks supervises construction of industrial facilities under the facilities contracts made by the other Bureaus.

66. The peak in the making of construction contracts and the peak of construction thereunder was reached in 1942. Commitments for all types of facilities (industrial and non-industrial) for the first half of 1942 totaled \$2,742,100,000, for the second half of 1942, \$1,420,400,000; expenditures for work completed in these two six-months' periods were \$1,275,000,000 and \$2,190,000,000 respectively. The bulk of facilities contracts executed in the last six months of 1941 and the first four months of 1942 extended beyond the date of passage of the renegotiation statute on April 28, 1942.

67. It has been estimated that roughly 80 per cent in dollar volume of construction contracts and extensions thereof made by the Bureau of Yards and Docks in fiscal 1942 required over 8 months to perform. Most of the very large construction contracts for construction of new bases extend over more than 12 months. It is of course impossible to compare costs or prices of different construction jobs, although prices of construction materials may be compared.

68. As to items procured by the Bureau of Yards and Docks, I shall cite as examples two items—pontoons and floating dry docks. The pontoon program was started near the end of 1941 with an order for a few thousand pontoons; the number contracted for multiplied over six times in 1942, and increased in 1943 far beyond what anyone had anticipated. The Bureau procures two major types of pontoons, one of which is procured in numbers about 9 times as large as the other type. Prices have come down as follows:

	1st type	2nd type (procured in the larger quantities)
1941 (includes development costs) .....	\$400	\$660
1942 .....	335	370
Late 1942 .....	1	250
1944 .....	270	200

Construction of floating dry docks began in 1941. These were an entirely new item, and extensive changes in specifications and design were made during the life of the early contracts. All of these contracts extended beyond April 28, 1942.

## II. ACTION BY THE NAVY DEPARTMENT WITH RESPECT TO EXCESSIVE PROFITS

69. The Navy Department in 1941 and the early part of 1942 had only begun to build up machinery for the purpose of ascertaining and recapturing excessive profits under its contracts. I have pointed out the enormous increase in the number of contracts and in the volume of Navy procurement during this period, and the impossibility of acquiring experienced personnel forthwith, to negotiate the best possible prices for the Government. During the period in question (the latter part of 1941 and the first four months of 1942), the Navy Department discovered that some of its contractors were earning very large profits. We endeavored to correct the situations which came to our attention. It proved impossible then to achieve close initial pricing under most Navy contracts. After our experience of the last several years I am convinced that it will always be impossible in wartime to arrive at close prices for munitions, when the Government is uncertain as to the types or quantities of munitions which are needed (and the exigencies of war are such that we are almost never certain as to types and quantities).

### a. 1941 Investigations.

70. In the first half of 1941, both the House Naval Affairs Investigating Committee and the Truman Committee sent out questionnaires relative to profits to manufacturers and shipbuilders

holding Navy contracts. The Truman Committee in June 1941, conducted hearings upon costs and profits under ship contracts and contracts for ship repair and alteration. These investigations brought out the fact that very large profits were being enjoyed by some contractors; the Truman Committee was particularly concerned with profits under ship repair and alteration contracts. Before these committees had published any reports, however, the Navy Department made efforts to correct some of the contract prices, particularly under the ship repair contracts. The first step was to make sure that the Bureau of Internal Revenue would treat a voluntary refund by a contractor as a reduction in his contract price and in his taxable income; in response to inquiries by the Navy Department, the Treasury Department, in September, 1941 indicated that for tax purposes it would so regard such a refund, provided the original contract was modified in writing to indicate the reduced price. Thereafter the Treasury further indicated that a refund made after completion of performance of the contract would likewise be regarded for tax purposes as a reduction of gross income.

71. Mr. Forrestal (then under secretary) and Rear Admiral Samuel M. Robinson (then Chief of the Bureau of Ships) in September of 1941 requested the Compensation Board to investigate the cost records of contractors who were to complete ships under Navy contracts in 1941 and the first six months of 1942, and to determine what the probable profits in the construction of those ships would be. The Compensation Board was an administrative agency which had been set up by the secretary of the Navy in the first World War to review costs under cost-plus contracts, and to advise the secretary generally on amounts claimed by contractors under Navy contracts. Its functions in reviewing costs under contracts had been taken over largely in late 1941 by the Cost Inspection Service of the Bureau of Supplies and Accounts (the Cost Inspection Service was given complete responsibility to inspect costs under cost-plus-a-fixed-fee contracts, except those made by the Bureau of Yards and Docks, by a directive of the secretary dated February 9, 1942). The Compensation Board planned



to have its accounting branch, the Cost Inspection Board, go over the cost records of contractors under outstanding vessel contracts and attempt to estimate what the profits would be under such contracts. It was anticipated that in cases where the profits appeared to be excessive, the Bureau of Ships, acting in conjunction with the Compensation Board, would endeavor to persuade the contractors voluntarily to reduce prices. The Bureau of Ships had estimated that by limiting the investigation to contracts for vessels to be delivered prior to July 1, 1942, performance would be close enough to completion so that a fairly accurate estimate of anticipated profits could be made. Both the Compensation Board and contracting representatives of the Bureau of Ships felt that it would be wise to persuade contractors in advance to modify their contracts to allow readjustment in prices to eliminate excessive profits, if possible—a forerunner of the renegotiation clause.

72. The Compensation Board was unable to carry this project to completion. It did begin investigation of costs under the ship contracts, but the outbreak of war and the transfer of the bulk of its cost inspection activities to the Bureau of Supplies and Accounts cut short the study of excessive profits of naval shipbuilders. The Bureau of Ships, aided by the Cost Inspection Division of the Bureau of Supplies and Accounts, late in 1941 began to carry forward certain of the work projected by the Compensation Board, in that it commenced negotiations with a number of shipyards under the ship repair and alteration contracts for revision of the contract billing rates.

73. At this same time, the House Naval Affairs Committee, acting as a special committee to investigate the national defense program, pursuant to House Resolution 162, approved April 2, 1941, was undertaking its study of excessive profits under Navy contracts. The Naval Affairs Committee had in April, May and June, 1941, obtained a list of all contractors with the Navy Department, and it sent out to these contractors a general questionnaire, which required the submission of extensive and explicit information on costs of performance of Navy contracts and profits thereunder. As responses were received from the contractors, supple-

mental questionnaires drawn to elicit information as to a particular industry, were issued to contractors in different industries. The committee stated that it had in the second and third quarters of 1941 sent questionnaires to 6,899 contractors holding 16,463 contracts. The questionnaires, which required a considerable amount of effort to fill out, aroused a good deal of protest, and also increased interest in excessive profits on the part of both the contractors and the Navy Department. (These questionnaires and the responses thereto are summarized in the committee's report issued January 22, 1942, H. Rept. No. 1634, 77th Cong., 2d Sess.)

74. By October of 1941 Representative Vinson, chairman of the House Naval Affairs Committee, felt that the committee had acquired sufficient data on profits of Navy contractors to indicate the need for corrective legislation. While he indicated to the Navy Department that the questionnaires returned to the committee showed that most of its contractors were realizing only a fair profit, he stated further that profits under certain contracts represented an "unconscionable percentage" of the contract price. Therefore, on October 7, 1941, he introduced H. R. 5787 (87 Cong. Rec. 7713) to provide for the recapture of all profits under Government contracts in excess of 7 per cent of the cost of performance thereof. At about this same time, another bill (H. R. 5739) was introduced imposing a flat percentage limitation of profits under war contracts—in this bill 8 per cent of the contract cost. The Navy Department was opposed at this time and later to the revival of any percentage limitation of profits, such as that contained in the Vinson-Trammell Act. It had had the experience under the Vinson-Trammell Act with such a type of profit limitation, and the officials responsible for procurement in the Department were confident that any reenactment of such a limitation would impede the procurement programs.

75. Some consideration was given within the Department in the last several months of 1941 to the best method of limiting profits by administrative action. The only concrete results of this consideration were the readjustments effected by the Bureau of Ships in payments under the ship repair and alteration contracts.

These contracts were in 'effect requirement contracts—i.e., the contractor agreed to perform, for compensation based upon reimbursement of cost of materials and a fixed price per man-hour of work; all orders for ship repair or alteration work which might be placed with him by the Navy Department. Around the 1st of December 1941, the Bureau of Ships began to seek voluntary reductions in rates from the shipyards. Between December 1, 1941, and April 1, 1942, the Bureau in effect renegotiated 27 ship repair and alteration contracts, representing a very substantial portion of the outstanding number of such contracts. At hearings before the Senate Naval Affairs Committee on profit limitations late in January and early in February of 1942, Captain Claud A. Jones (assistant chief of the Bureau of Ships) indicated that the Navy had recovered about \$2,000,000 in profits by renegotiation of the ship repair and alteration contracts.<sup>2</sup> This figure does not, of course, indicate the savings which would accrue in the future by reason of the renegotiation of such contracts.

76. The work of renegotiating the prices under these contracts was spurred by publication on January 15, 1942, of the Truman Committee's report, which covered among other things profits under Navy contracts for shipbuilding and ship repair and alteration. On January 22, 1942, the House Naval Affairs Investigating Committee issued its first report on the defense program, which dealt extensively (409 pages including appendices) with the matter of profits under Navy contracts.<sup>3</sup> While the committee noted that average profits under the contracts let by the several Navy bureaus were not too much out of line, it did indicate some examples of extremely high profits. These profits were unduly high despite the excess profits tax. The whole report dealt with profits in terms of percentages of the contract price. It pointed out that the percentage of profits on sales was greater under uncompleted contracts than under completed contracts, and that as the defense

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<sup>2</sup> Hearings before the Senate Naval Affairs Committee on H.R. 6355, S. 2027, 77th Cong., 2nd Sess., Page 7.

<sup>3</sup> House Report 1634, 77th Cong., 2nd Sess.

program progresses, the profits to the contractors are increasing and will tend to increase unless steps are taken to halt the trend. Much emphasis was placed upon this report by the Navy officers responsible for procurement. It also received very wide publicity at the time; the newspapers were full of editorials about the prevention of war profiteering, and the procurement officials of the Navy Department spent a considerable amount of time over the next several months in seeking to devise some more effective means of administratively limiting profits under Navy contracts.

b. Study and Suggested Solutions within the Navy Department, February-April, 1942.

77. From the end of January, 1942 on, the efforts of Navy procurement officials to find some solution to the problem of policing of costs and profits were redoubled. While no formal organization had been set up to deal with the matter, several groups were devoting most of their time to an investigation of ways and means for limiting profits. The procurement personnel of the several bureaus worked closely with the investigating personnel of the House Naval Affairs Committee, and were instrumental in suggesting to the committee most of the contractors whose profits were so large as to merit further investigation. The Department was during this same period attempting to work out a sound organization to handle the entire procurement problem, let alone the matter of war profits. It was on January 30, 1942, that the efforts towards coordinating the divergent procurement activities of the several bureaus culminated in the establishment of the Office of Procurement and Material in the secretary's office.

78. At the under secretary's request I devoted a large part of my efforts during the months of February, March, and April, 1942 to working out some means of curbing profits under our contracts which would not interfere with the more important objective of obtaining the munitions and supplies required by the Fleet. I spent a great deal of time during this period in discussing this problem with representatives of the Procurement Branch in the newly formed Office of Procurement and Material, the contracting



branches of the several Bureaus, and the accounting personnel in the Bureau of Supplies and Accounts. During these three months the under secretary also brought into the department several men with wide business experience who looked into the entire matter of profits under Navy contracts and who subsequently became members of the Price Adjustment Board (established several weeks prior to passage of the renegotiation statute). The problem of the right way (if there were any "right" way) of handling the problem was, however, still very much in the formative stage—it was not then possible to set up any more definite organization to handle the matter of closer pricing and excessive profits. In February we held several discussions with representatives of the Army procurement services as to the best cure for excessive profits, and considered a proposal to include in war contracts clauses under which the contractor agreed to consider adjustment or renegotiation of the contract prices.

79. Early in March, I submitted to the under secretary, on behalf of the Navy group which had been studying the problem, some tentative conclusions. It was the consensus, first, that the Navy Department must continue to rely upon the "profit motive" as an important factor in inducing war production, but that nonetheless, excessive profits had a bad effect on public and military morale and also tended to encourage demands for wage increases and decreases in labor efficiency. With respect to the proposal to limit profits to a flat percentage of the cost of performance of contracts, it appeared probable that industry would insist upon a floor under losses if it were to be subjected to a ceiling upon profits. This floor under losses could be accomplished only under a cost-plus type of contract, which was expensive to supervise and audit, tended to reduce efficiency, and often permitted very high profits on a yearly basis; and the 7 per cent limitation on the fee allowed under such contracts, while low for some businesses, permitted very high returns for other businesses. The amount of manpower and effort required to audit such contracts or to administer the flat percentage type of limitation under fixed-price contracts would be enormous and probably could not be drafted if this limitation were

put into effect. With respect to excess profits, it was our position that corporations must be permitted to retain some portion of their profits in order to preserve the influence of the profit motive and in such event the amount of profits before taxes in view of the extraordinary ballooning in some industries was often so large as to leave excessive profits even after taxes. There was no easy answer to the problem of effective profit control. It was my view at that time that we should attempt to do as much as we could by starting at the very beginning—in the negotiation of contract prices. The Government should be represented in such negotiations by experienced and skillful negotiators who would endeavor to see that the maximum of effort was produced at the right price. We realized then that in the light of all of the imponderables, even skilled negotiators would be unable to achieve close pricing in many instances. It was recommended to the under secretary that experienced price negotiators be placed in each of the contracting Bureaus. This suggestion was discussed at considerable length in various meetings and bore fruit several months later in the establishment of a Price Negotiation Section in the Bureau of Supplies and Accounts, which was ultimately extended to all of the bureaus of the Navy Department.

80. At about this same time (early March, 1942) as a result of our several discussions within the Department, consideration was given to a proposed directive to be signed by the secretary with respect to the allowance of reasonable profits on fixed-price negotiated contracts. It was proposed that prices be fixed to allow a profit of 6 per cent generally, but up to 10 per cent, of the estimated cost of the contract, to be determined on the basis of cost data and financial statements submitted by the contractor—in short, an embodiment in each contract of the Vinson-Trammell type of limitation, applied in advance. The directive was discussed in considerable detail on March 13, 1942, by representatives of the several bureaus, the special assistant to the under secretary, Vice Admiral Robinson (chief of the Office of Procurement and Material), and myself. We were agreed at this meeting that the proposed directive would tie the Navy Department completely to

the percentage limitation of profits concept, with all of its inherent deficiencies. We therefore decided that we would not recommend that any such directive be signed by the secretary at this time, and that we would attempt further to devise some effective means of control of profits within the Department. One feature of the proposal was revived several weeks later—namely, the requirement that the contractor submit statements as to the estimated cost of performance of his contract and other financial data in connection with the performance of Government contracts. Some time thereafter this did become the standard practice.

81. At this same time the War and Navy Departments and the War Production Board had been working upon the establishment in each of the three agencies of cost analysis sections, which would be able to point out profit danger spots and suggest administrative remedies therefor. On March 17, 1942, representatives of the Office of Procurement and Material who had participated in these discussions circulated a proposed outline of procedure for the establishment and workings of such sections. This suggestion provided for the close coordination of the proposed cost analysis sections in the three agencies, and provided further that the War Production Board would attempt to supply a check on the selection of contracts for cost analysis so that the program would not put an unmanageable burden upon the accounting offices of the three departments. After further discussion of ways and means, the cost analysis sections were set up about three weeks later. The War Production Board was to function primarily in analyzing the cost reports prepared by the War and Navy Departments.

82. In the latter part of March Messrs. Kenneth H. Rockey and Sylvan Coleman came into the Department at the under secretary's request to study the whole matter of excessive profits and closer pricing. Messrs. Rockey and Coleman went over the rather substantial data which we had by this time accumulated and spent considerable time with the contracting officers of the several bureaus in reviewing contracting procedures and the methods then available for determining whether or not excessive profits were being earned. Both of them took a very active part in the discussions

which were then occupying most of the time of the group studying the matter of excessive profits. When the Navy Price Adjustment Board was established about April 20, 1942, Mr. Rockey was made its chairman and Mr. Coleman was made a member of the Board.

83. In the course of our study, some of the cases of excessive profits enjoyed by subcontractors were brought to our attention. We learned of several instances in which the prime contractor with the Navy Department had given subcontracts to one of its subsidiary companies, and had included in its cost figures under the prime contract allowances for profits of subsidiary contractors. We sought to require representations by the prime contractor which would prevent any repetition of such practice. Of course, we recognized that any scheme of percentage-profit limitation tended to favor high profits for subcontractors; the prime contractor would not be interested in keeping subcontract costs or prices low, since the higher such costs or prices were, the higher the base on which his percentage of profits would be figured. Also, there were some instances where work was subcontracted directly and the fee of the subcontractor was added to the fee of the prime contractor to make for double profits on the same work.

84. During the last week of March, 1942, the House Naval Affairs Investigating Committee held hearings on excessive profits being earned by several large Army and Navy contractors. These hearings were extensively reported in the newspapers, and the large profits earned by the Continental Motors Company and of Jack and Heintz received particular attention. The Naval Affairs Committee had received most of its data on these contractors from a joint audit which had theretofore been undertaken by the Army and Navy. The hearings had the helpful result of producing a number of meetings between Army and Navy representatives for joint consideration of the best means of limiting excessive profits. At such a meeting on March 25, 1942, it was concluded that each Department should have available an organization to which would be reported all cases wherein it was suspected that contractors were earning excessive profits. The meeting envisioned that these organizations would function about as follows:



a. All procurement officers would be advised of the establishment of the two organizations, and requested to refer to them for further investigation cases of excessive profits.

b. A conference would be called between the contractor and representatives of all Government agencies holding contracts with such contractor. At this conference, the profits would be considered with a view to obtaining for the Government a return of profits deemed excessive or a reduction of the contract price by the amount of such profits, whichever might be appropriate.

c. The meeting contemplated that in the cases of recalcitrant contractors, resort might be had to compulsory orders under Section 9 of the Selective Training and Service Act; and further that in appropriate cases full publicity would be given to the excessive profits and the action taken.

The March 25th meeting further determined that immediate action along the lines indicated would be taken jointly by the services in the case of Continental Motors. In general, the War and Navy Departments were agreed that each case should be dealt with on an individual basis, although at the outset it might be advisable to approach a group of contractors (perhaps those mentioned at the hearings of the House Naval Affairs Investigating Committee) and to deal with them in a body. It was agreed that the proposed action would be reported to the Congress to indicate the bona fide efforts being made by the War and Navy Departments to achieve answers to the problems of excessive profits. This meeting really represented the birth of the Price Adjustment Boards.

85. The War and Navy Departments thereafter discussed with the War Production Board this proposal to set up bodies to investigate war profits. Growing directly out of these discussions was the proposal that a presidential board be appointed to serve throughout the war for the purposes of studying the experience of other nations as to profit limitation, formulating a comprehensive program for the prevention of excessive profits, suggesting legislation and procurement policies as deemed appropriate, and dealing with special difficult cases. The proposal contemplated

that Congress, the Army and Navy and other war procuring agencies would be able to look to such Board for guidance and advice.

86. By the time this matter was brought up for consideration, however, H. R. 6790, the revival of the Vinson-Trammel percentage limitation, had been introduced (March 16, 1942); and Representative Case had introduced his amendment to H. R. 6868, providing for the renegotiation of contract prices to eliminate all profits above 6 per cent (March 28, 1942). These proposals were discussed with representatives of the Army and the War Production Board, and representatives of the Navy presented to the House Naval Affairs Committee and to the Senate Finance Committee our views with respect to them, and commented upon the several revisions of the renegotiation proposal which were submitted to us.

87. The passage of the Second War Powers Act, 1942, on March 27, 1942, afforded an additional weapon to the Navy Department and the other war procuring agencies in the investigation and determination of excessive profits. Title XIII of this Act allowed the agencies, when so authorized by the president, to inspect and audit the books and records of their contractors and to require such financial data as they desired. The president, by Executive Order 9127 dated April 10, 1942, delegated this authority of investigation and audit to the procuring agencies, subject to certain conditions. The Departments were enabled to go into the plant of any contractor and require the submission to them of all information as to profits.

88. The Cost Analysis Section and the Price Adjustment Board were formally organized in the Office of Procurement and Material about April 20, 1942, and were specifically called to the attention of all procuring officers of the Department by a memorandum circulated on April 24, 1942.

89. The informal group which had preceded the formal establishment of these two organizations, the Bureau of Ships and the Cost Inspection Division of the Bureau of Supplies and Accounts, had meanwhile in the first four months of 1942 continued to readjust and renegotiate contract prices. The accomplishments

of the Navy Department in reducing prices up through June of 1942 were summarized in the report of the House Naval Affairs Investigating Committee of July 22, 1943.<sup>4</sup> The committee had obtained the names of specific contractors investigated and a great deal of the data on the excessive profits which they were enjoying, from the departments. The committee included in its report a summary of the "actual monetary savings to the Navy Department" as a result of renegotiation of contracts. It indicated that the Navy had effected such savings to the extent of some \$88,000,000. While the committee did not so indicate, the great bulk of this amount constituted reductions in contract price rather than returns of cash received by the contractors. Furthermore, as the committee did point out, the renegotiations effected at that time would later show substantial results in lowering prices on new contracts for the munitions for which the original contracts had shown excessive profits. With respect to the ship repair and alteration contracts, the committee remarked that refunds under these contracts amounted to \$7,000,000 (which is to be compared with the \$2,000,000 which had been recovered by the end of January, according to Captain Jones' testimony). As the volume of ship repair and alteration work had increased under these contracts, profits had expanded rapidly under rates which had been fixed in the absence of any adequate experience in this type of work. Under contracts of this type, the Bureau of Ships had been fairly successful in renegotiating profits to allow no more than 10 per cent of costs (as compared to an average profit on such contracts prior to their readjustment of 30 per cent of their cost of performance).

90. I am unable to present any concrete figures from the Navy Department as to the total cash refunds of profits by Navy contractors prior to April 28, 1942. Apparently all of the cash refunds were collected by means of deductions from vouchers; no record had been kept of any such deductions, and it would be an interminable undertaking to examine the vouchers under each con-

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<sup>4</sup> H. Rept. No. 2371, 77th Cong., 2d Sess., pp. 26-32.

tract in the anticipation that they might reveal voluntary reductions in price. In addition, any recapitulation of the cash refunds would not show the whole picture, for most of the savings to the Government in the elimination of excessive profits were effected by means of price reductions.

c. Consideration of the Percentage Profit Limitation Proposals.

91. Meanwhile, the Congress had been considering several proposals to impose a percentage limitation of profits upon Government contracts, and there appeared at the time to be a very strong chance that such a method of limitation would be enacted by the Congress. These proposals, to which the Navy procurement officers were unalterably opposed, naturally spurred the efforts within the Department to arrive at a solution to the profit limitation problem. On March 16, 1942, there had been introduced in the House H.R. 6790, which proposed among other things to limit profits on all Navy contracts to 6 per cent of the cost of performance thereof. The bill was referred to the House Naval Affairs Committee, which held a number of hearings upon it in late March and April, 1942.

92. Both Mr. Forrestal and Colonel Knox testified with respect to H.R. 6790. Mr. Forrestal called attention to the vast amount of auditing work which would be necessary to enforce any such limitation, and discussed our experiences under the Vinson-Trammell Act. The secretary, who testified on April 16, 1942, brought out the immense variety of factors which affected profits under a particular contract and the impossibility of any single cure for excessive profits applicable to all contracts. He pointed out one very important consideration which the Congress had not thus far emphasized—the importance of reducing costs to the Government as well as profits. As he suggested, high costs and reduced profits often went hand in hand, and high costs could be much more expensive to the Government than high profits.

93. The Navy had had some experience in the difficulties of obtaining good accountants and auditors to handle the growing dollar volume of cost-plus-a-fixed-fee contracts. In early 1942, there were in the Cost Inspection Service of the Bureau of Supplies



and Accounts, which audited costs under these contracts, some 2700 accountants (most of whom were stationed outside Washington); in addition there were a substantial number of accountants in the Bureau of Yards and Docks, which audited its own construction contracts. H. R. 6790 proposed to have costs under Government contracts determined by reference to Treasury Decision 5000 (the regulation under the Vinson-Trammell Act), which was then used as a guide for auditing costs under the cost-plus-a-fixed-fee contracts. The determination of costs was a burdensome and time-consuming job, and there were substantial differences of opinion as to what items were properly allowable costs. The complete post-audit of expenditures under the cost-plus contracts by the general accounting office, after audit by the services, further complicated the difficulties of administering the cost-plus-a-fixed-fee contracts. It seemed clear that there would not be enough accountants in the nation to scrutinize costs under every Government contract, as contemplated by H. R. 6790, in the same way that costs were scrutinized under the cost-plus contracts.

94. H. R. 6790 was tabled in committee, for the renegotiation bill had been brought to the fore by the Congress. Section 403 of H. R. 6868, as reported out by the Senate Appropriations Committee, contained in subsection (f) a graduated range of percentage limitations to be applied to Government contracts of different size. Representatives of the Navy Department joined the representatives of the other war procuring agencies in discussing this subsection with the Senate Committee, which ultimately agreed that the percentage limitation feature should be deleted.

#### d. Maximum Price Controls.

95. The matter of price controls upon munitions was considered by the under secretaries of the Navy and War and the price administrator in late 1941. They decided at such time that it would not be necessary to set up any formal machinery for handling differences of opinion between the armed forces and the price administrator with respect to prices, but that each problem would be handled as it arose. The situation was changed substantially by

the approval on January 30, 1942 of the Emergency Price Control Act of 1942. The armed services had in the consideration of the bill which became the Price Control Act recommended that munitions be expressly exempted thereunder, but their suggestion was rejected. The possible imposition of maximum price ceilings on munitions pursuant to this Act was a rather unsettling factor in the whole discussion of possible methods for control of profits during the next several months. At the time of passage of the Act, the price administrator had not determined upon a policy as to the establishment of ceilings for the purpose of preventing war profiteering and of controlling prices under contractors for war material. On the day the renegotiation statute was approved—April 28, 1942—the Office of Price Administration issued its "Big Freeze" order, the General Maximum Price Regulation, and its Machinery and Parts Regulation (Maximum Price Regulation No. 136). The coverage of these regulations included a great many items of completed munitions and almost all components thereof, although certain specified munitions were to be exempted from the price ceilings established under the regulations. Broadly speaking, the General Regulation fixed the price ceilings by reference to the prices in effect during March, 1942, and required specific authority from the Office of Price Administration for the fixing of ceilings where there were no analogous March 1942 prices; and the Machinery and Parts Regulation fixed ceilings by reference to the prices in effect October 1, 1941, and also required specific authority from the Office of Price Administration in cases where there were no analogous October 1, 1941, prices.

96. The issuance of these regulations precipitated an immediate and prolonged discussion between the armed services and the Office of Price Administration as to the desirability of fixing price ceilings for munitions and their components. As a stop-gap measure, the price administrator postponed application of the regulations to sales and deliveries under Army and Navy contracts until July 1, 1942. In the latter part of May, 1942, the under secretary of the Navy established a liaison office in the Bureau of Supplies and Accounts, which was to integrate the price policies of the

Navy Department and the Office of Price Administration insofar as possible.

97. It had been the position of the Army and Navy in all of their consideration of price control that it would be unwise and impracticable to apply price regulations to strictly military and naval equipment, and that attempts to do so ran the risk of impeding procurement of such equipment. It was felt that the services responsible for war procurement must have final power over prices; such services were charged with full responsibility for procuring the articles with which to fight the war, and proper prices might well be an inextricable element in such procurement. In the latter part of July, 1942 the under secretaries of war and of the Navy notified the price administrator that while they recognized the necessity of adopting all possible means to prevent inflation, they felt that it was necessary to exempt military and naval supplies from the application of price ceilings. The under secretaries pointed out the difficulties inherent in effectively applying ceilings to munitions—e.g., the wide variety of conditions and uncertainties faced by contractors, the changes in specifications, inexperience of contractors, necessity of using all contractors and procuring all items regardless of cost. They further pointed out the probable impediment to production and procurement which the imposition of price ceilings would bring about, the undesirability of divided authority with respect to procurement, and the uncertainty and delay which would result from the application of the price regulations to Army and Navy contracts. Finally, they requested that "all articles which are designed and produced exclusively for military uses, and all subassemblies and parts of such articles which are themselves designed and produced exclusively for such military articles" be exempted from price regulation by the Office of Price Administration, with the exception of articles subject to regulation prior to June 30, 1942; that in questionable cases exemption be granted upon certification by the secretary of War or of the Navy that the exemption was necessary for the prosecution of the war. The under secretaries pointed to the authority to renegotiate contract prices under the recently enacted renegotiation statute as a

means at their disposal of controlling excessive profits and preventing inflation.

98. After further consultation, the Price Administrator responded in September, 1942 by indicating that he would not extend maximum price control in the area of strictly military goods, provided he received assurances that the Army and Navy would use their powers to control both prices and profits in the exempted areas. He further indicated willingness to consider any requests for exemption of particular items at that time under formal price regulations. The Office of Price Administration agreed not to extend price control to sales of strictly military goods. It was understood that the exact line of demarcation between military and non-military goods would have to be more precisely drawn after conferences among the three agencies. The War and Navy Departments accepted the proposal as drawn by the Price Administrator, and agreed to furnish his office with such information as it requested on the prices and procedures of the two Departments. Thereafter the armed services did establish divisions which furnished to the Office of Price Administration all information on prices requested by such office.

99. Prior to the passage of the renegotiation statute, the top Navy officials in charge of procurement had spent a very considerable amount of time in seeking to evolve some answer to the extraordinarily difficult problem of limiting war profits while at the same time executing the vastly accelerated procurement programs.

100. There was virtual unanimity of opinion that the percentage limitation of profits was not a solution to the Navy problem—experience indicated that it was not effective and that it made contractors hesitant to take Government contracts. Indeed, it made many manufacturers want to become subcontractors rather than prime contractors. The limitation of adequate accounting personnel was an even more compelling practical reason for the rejection of this means of profit control. Similarly, we had neither the inclination nor the necessary personnel to extend the use of the cost-plus-a-fixed-fee contracts to fields wherein we were able



to use fixed-price contracts. We knew from actual experience that exorbitant profits were being earned despite the recoveries under the excess-profits tax. The proposal to subject munitions to price ceilings had been seriously considered by the time of passage of the renegotiation statute, although the matter was not settled until the latter part of 1942.

101. The Navy Department was, then, in early 1942 in the position of opposing the known and theretofore attempted methods of limiting war profits, either because some of them were ineffective or because others would in the opinion of those responsible for procurement seriously interfere with war production. We would quite frankly have preferred at this time to work out our own administrative solution to the problem of limiting profits under Navy contracts, primarily through analysis of costs and closer pricing. The solution proposed by the Congress in the renegotiation statute, however, appeared to us to be a much better method than any alternative statutory method available. In retrospect, I believe that it is the better approach and that our earlier preference would not have solved the problem.

### III. NAVY CONTRACT FORMS AND CLAUSES.

102. The advent of the negotiated contract completely changed the form of the Navy contract and made necessary the use of much more intelligence and skill in the preparation of contracts.

103. Contracts awarded to the highest bidder after solicitation of competitive bids had all been based upon Forms 32 and 33 prescribed by the Procurement Division of the Treasury Department for all Government agencies. Such forms of contract, with their boilerplate provisions, were satisfactory only for simple deals, and proved quite inadequate for negotiated contracts. The first break away from these restrictive forms came in the preparation of construction contracts and contracts for the construction or installation of industrial facilities (in 1939 and 1940). In developing provisions for the facilities contracts—financing the contractor, purposes for which the facilities were to be used, rights of the parties upon the termination of the emergency period, and the

like—it was obvious that the contract would have to be tailor-made to fit the particular arrangement. Furthermore, in the course of drafting these various provisions to fit the procurement transaction, the boilerplate provisions were scrutinized and were often improved or made more appropriate. The grant of authority to negotiate certain contracts for vessels and supplies (in June, 1940) further accelerated the process of critical examination of the contract provisions and the drafting of intelligible new provisions to meet particular needs.

104. After enactment of the First War Powers Act, 1941, and the promulgation of Executive Order No. 9001, the secretary removed entirely the restrictions of Form 32 in the preparation of negotiated contracts. The secretary's directive of December 28, 1941, established a new internal Navy procedure for clearing contracts negotiated under the War Powers Act; in addition, it delegated to contracting officers complete discretion with respect to the form of such contracts, except for certain specified provisions required by statute or executive order. Under this delegation of authority, contracting officers were granted complete discretion to make advance, partial, and other payments on account of the contract price,

without limitation as to amount and irrespective of any provisions of law as to security liens (except as [to the lien in favor of the Government as permitted by the Act of August 22, 1911, 34 U.S.C. 582]) or otherwise, except that advance payments should be carefully scrutinized to determine whether such payments are necessary for the satisfactory performance of the contract in accordance with the terms thereof and as much security by means of controlled accounts or otherwise shall be provided for as may be expedient under the circumstances of each case.

The directive further specified:

Such contracts [under the War Powers Act] may be made with or without competitive bidding as the respective contracting officers in their discretion may determine. There

shall be no limitations or restrictions as to form and substance of such contracts except [the contract clauses required by statute or executive order].

The contracting officers are authorized to select such procedures in making contracts as are deemed best fitted to the purchases involved and the needs of the Navy.

105. At this time all instructions relative to contracts were in the form of individual directives by the under secretary to the bureau chiefs, who transmitted such instructions to the officers under them responsible for preparing contracts. Since the great majority of Navy contracts were made by the bureaus in Washington, these directives could be rather informally issued and distributed. In general, they gave a wide degree of discretion to the bureaus in the preparation of contract provisions. As we began to pay more close attention to prices and the elements which went into prices, it became necessary to issue more detailed instructions relative thereto; it was not until October, 1943, however, that we were able to collect the contract directives in one place, arrange them, and issue them in a loose-leaf volume (the Navy Procurement Directives).

106. I shall summarize very briefly the more or less common Navy contract provisions prescribed in the first several months of 1942 for the determination or adjustment of prices or costs.

i. Changes.

107. All Navy contracts included provisions for changes in the work covered thereby. The changes clause in all Bureau of Ships contracts was broader than that in other contracts made by the Navy.

The Bureau of Ships clause provided:

The Secretary of the Navy, at any time and without notice to the sureties, may make changes in this contract including the General Provisions, the plans or specifications of this contract, within the general scope thereof.

This type of clause had been in ships contracts since the 1880's. The broad language of the clause had, by construction, been somewhat limited in scope. The clause was eliminated about a year ago, and the ships contracts now contain provisions limiting changes to the work under the contract, as in other Navy contracts.

108. With respect to changes in price upon a change in specifications or in the work under the contract, the more or less standard clause for fixed-price contracts provided that if the changes caused an increase or decrease in the cost of performing the contract, "an equitable adjustment" would be made and the contract modified in writing accordingly; facilities and cost-plus-a-fixed-fee contracts provided that upon the making of changes "an equitable adjustment of the estimated cost and the fixed fee would be made and the contract modified accordingly". In the event of failure to agree upon a change in the fixed price or fixed fee, the matter was to be decided by the contracting officer pursuant to the disputes clause of the contract. The cost-plus-a-fixed-fee contracts for vessels provided specifically that if the estimated costs were changed as a result of changes in specifications, the fixed fee, which was stated to be about 7 per cent of the estimated cost, should be changed by 7 per cent of the change in the estimated cost.

#### ii. Payments.

109. The contracts provided specific procedures for submission of invoices covering costs under cost-plus and facilities contracts, and for prices of goods delivered under fixed-price contracts. These provisions varied substantially among the different types of contracts.

110. Fixed-price contracts for vessels called for partial payments as construction of the vessel progressed. The provisions for advance payments under fixed-price contracts specified that a lien should be established in favor of the Government on the materials and property acquired by the contractor. In some instances controlled accounts were established, providing a check by



the contracting officer upon the advance payments to the contractor; the advance payments clauses were at this time relatively simple as compared to clauses presently in use.

### iii. Insurance and bonds.

111. All contracts required the contractor to carry insurance on the property produced or acquired thereunder, and to carry workman's compensation and other third-party liability insurance with respect thereto. The Government generally undertook to make the contractor whole for losses sustained in excess of the amounts covered by insurance taken out at the direction of the contracting officer.

112. After passage of the War Powers Act, performance and other bonds were largely dispensed with, although they were still required for certain standard supply contracts made by the Bureau of Supplies and Accounts. In any event, the performance, payment and similar bonds had never been of much use to the Navy. It had invariably proved impossible to obtain bonds at any cost in the cases where they were most needed. Generally the cost of bonds was high and the amounts of coverage in the case of large contracts were entirely inadequate to protect the Government.

### iv. Patents.

113. Whenever patents were involved in the procurement, the standard clause of the Treasury Procurement contracts was used—the contractor agreed to hold the Government harmless against claims for infringement of patents in the performance of the contract. Some ships contracts contained the further requirement that the contractor not pay any sum for royalties or patent rights not included in the ordinary purchase price of parts embodied in the ships, unless and until duly so authorized by the contracting officer. No real progress was made in the matter of controlling royalties and other payments relative to patents under Navy contracts, and in drafting patent clauses which adequately protected the interests of the Government, until after the Procurement Legal Division was authorized to handle such matters in August, 1942.

## v. Termination.

114. Navy contracts (except Bureau of Ships contracts) at this time provided that in the event of cancellation for the convenience of the Government, the Navy would pay the contractor for all costs, including a proper allocation of overhead expense to the contract, incurred up to the time of termination, plus an allowance of 6 per cent or 7 per cent profit on all such costs except purchases of materials and unfinished goods, for which the contractor was reimbursed at cost. This provision differed from the clause then used by the Bureau of Ships and the Army, which calculated the profit on the estimated extent of completion of the contract—the contractor was paid a percentage of the total profit equal to the percentage of completion. The use of any clause was a vast improvement over the practice in the first World War, when contracts did not contain any termination clauses.

115. Navy contracts, other than ships contracts, also had included clauses authorizing termination for default, corresponding to the delays-damages clause of the old Treasury Form 32—if the Government terminated for default in delivery, it had the right to purchase the goods elsewhere and surcharge the contractor for any additional costs incurred by reason thereof by the Government.

116. After the Fit it War Powers Act, the Navy dropped almost entirely the liquidated-damages clause. At this time there were frequent delays due to changes in specifications, material and labor shortages and the like, and it was often if not usually difficult to hold the contractor responsible for delays in deliveries. In addition, contractors were extremely reluctant to take contracts containing such clauses. As the Navy was interested in getting the goods themselves, and not money damages, it determined to omit this clause generally.

## vi. Guarantees.

117. Most contracts in early 1942 contained a clause under which the contractor undertook to guarantee for a certain period the performance or durability of the articles covered by the contract in conformity with the specifications. This period varied

from 3 months to a year or more. The contractor further undertook to correct or repair at his own expense any deficiencies or failures in the contract articles during such period. The ship contracts provided for trials, and adjustments and corrections by the contractor of the vessels during such trials. If the contract was a fixed-price contract, the contractor would often include large contingencies in his prices to cover possible expenses during the guarantee period. Since 1943 and 1944 the period of the guarantee has been shortened, and the clause has been entirely eliminated in a few cases from Navy contracts.

vii. Escalator clauses in fixed-price contracts.

118. Most fixed-price contracts for any substantial amount in late 1941 and early 1942 contained provisions for adjustment in price upon changes in material or labor costs. I should estimate that a majority in dollar amount of fixed-price contracts executed during this period contained escalator clauses. These clauses varied substantially in scope and in the index selected to measure increases in costs.

119. Some of the more primitive types of clauses had attempted to protect the contractor to the full extent of any cost changes. Almost all of the clauses in use at the time the renegotiation statute was being debated, however, attempted to protect the contractor not against all variations in the cost of labor and materials, but only against such changes in those costs as might be attributed to general changes affecting the entire national economy and thus wholly beyond the contractor's control. The basis for calculating changes in costs under the escalator clauses were in most cases indices representing wage levels (either general or for a specific industry) and material costs, usually indices published by the Bureau of Labor Statistics.

120. The most important determination in any escalator clause was the selection of the base to which the percentage of change in a selected index is applied in order to calculate the permitted adjustment of the contract price. The base selected varied widely among the several contracts, and was often extremely complicated

to compute—requiring in some cases substantial cost accounting. All of the escalator clauses are rather complicated to apply. The computations under most of them were made by the Cost Inspection Service of the Bureau of Supplies and Accounts. We have subsequently discovered certain errors in the drafting and application of certain clauses; whereby increases were computed on costs including the price increases against which the escalator clause was designed to protect the contractor. We corrected such increases as they were called to our attention.

121. All escalator clauses are to some degree inflationary and are harmful in that respect. The device had many disadvantages—it was used only because the Navy could not persuade contractors to take contracts on any other basis. Because of the uncertainties as to labor and other costs and the impetus to inflation which any war provides, contractors refused to run the risk of being tied to a fixed-price under a long-range contract. Escalator clauses were to be used only in long-term contracts. Our need for munitions was so great, however, that we could not quarrel very much over inclusion of such provisions. It must not be assumed that because an escalator clause was included in a contract, the price fixed therein did not include any allowance for contingencies. As has been made quite evident later, the price did include substantial allowances for contingencies. Furthermore, as I have indicated, the escalator clause was not a complete answer to the contractor's insistence upon protection. The clause purported to protect him only against certain direct labor and material price increases and did not protect him against other labor and material costs or other indirect costs which were subject to real fluctuation. The device was an imperfect one which it was necessary for us to adopt in order to speed procurement. Even with the elimination of the risks covered by the escalator clauses, contractors were able in some instances to make profits aggregating 50 per cent or more of cost, as witness the ships contracts which I earlier cited.

122. On January 30, 1942, the Emergency Price Control Act was approved. The adjusted increases in contract prices under



the escalator clause had to stop at any ceilings established by the price administrator on articles purchased or produced under the contract. At that time it was not known just how the Act would affect price escalation; subsequently specific escalator clauses have been worked out for contracts covering certain materials subject to OPA ceilings.

#### IV. NECESSITY OF THE RENEGOTIATION STATUTE.

123. Had the renegotiation statute not been enacted, I am convinced that Navy procurement would have been affected in the following ways, among others:

- a. greater use of cost-plus contracts;
- b. enforced use of mandatory orders to obtain munitions with respect to which agreement on price could not be reached;
- c. reluctance on the part of contractors to take prime contracts, including preference for subcontracts; and
- d. excessive profits and waste.

These probable results are to a large degree all tied together. We should have found it more and more difficult, I believe, to allow the large contingencies demanded by contractors in fixed-prices, and should therefore have been driven to a much wider use of the cost-plus-a-fixed-fee contract and the mandatory order. I have earlier described the lack of incentive to reduce costs which is inherent in the form of the cost-plus-a-fixed-fee contract, and the large number of auditing personnel required to determine allowable costs under such contracts. Mandatory orders constitute a somewhat ponderous means of procurement, and leave the Government with the pricing problem still on its hands, plus possible court proceedings. There can be little doubt but that profits would generally have been larger in the absence of renegotiation. After a study of the complex problem of limiting profits in war to fair and reasonable amounts—the problem both as we faced it in the past and as we have faced it in this war—I know of no other type of profit limitation which can take into consideration

the many diverse factors affecting the profits of different contractors and fairly adjust those profits, as adequately as does the renegotiation process. The growing Congressional and public criticism of exorbitant war profits in 1941 and 1942 would have resulted in an increasing reluctance on the part of manufacturers to take war contracts, and eventually in some form of profit limitation less palatable and less equitable than renegotiation. I am strongly of the opinion that, while the Government should consistently seek to improve its negotiating procedures in arriving at close prices, the problems of war procurement render impossible any completely satisfactory solution of the problem of initial pricing. Renegotiation, which affords a review of prices after the contractor has had the cost experience in the performance of his contracts, is to my mind an essential part of wartime procurement, today as well as in early 1942.

H. STRUVE HENSEL.

Sworn and subscribed before me this tenth day of July, 1945.

LUCILLE HOLLAND,

[SEAL] ✓

Notary Public, D.C.

My commission expires September 1, 1946.

#### AFFIDAVIT OF ALBERT I. ALEXANDER.

Then personally appeared Albert I. Alexander, of North Andover, Massachusetts, and being duly sworn deposed on oath and said as follows:

The defendant is a Massachusetts corporation organized in 1941. It commenced business about October 1, 1941. Its business, as its name indicates, is primarily that of combing grease wool into tops and noils. Wool tops consist of a strand of the longer fibres of clean wool, of fairly uniform diameter, wound into a ball. Wool tops are sold to the worsted trade who spin them into yarn and weave the yarn into cloth. Noils are the shorter fibres sold to the woolen trade. Wool, wool tops, and noils are graded by the diameters of the fibres, which are desig-

nated by numbers, as 70s, 64s, 62s, 60s, 58s, etc., the higher numbers referring to the finer and more valuable fibres. They are also classified by other characteristics, notably the place of their origin. Any one lot of grease wool may contain a number of different grades. The operations involved in the business of the defendant involve handling, storing, sorting, scouring, carding, and combing wool. Ordinarily, sorting will result in a main sort, so-called, consisting of 70 to 80 per cent of the grade of wool which it is desired to make into tops, say 64s, and the balance offsorts, either coarser or finer grades. Scouring removes the grease and any foreign materials in the wool. The amount of the grease and foreign materials varies within rather wide limits. The shrinkage, so-called, may run from 30 per cent to 80 per cent of the grease weight. Carding and combing result in the production of waste. A typical lot of wool, say of 1,000 pounds, might sort to 800 pounds of 64s, the balance being offsorts to be added to other combing lots. The 800 pounds of 64s in the grease might be reduced to 400 pounds of clean wool. Those 400 pounds when carded and combed might result in 320 pounds of top, 64 pounds of noils, and 16 pounds of waste.

The business of combing wool into tops and noils is conducted by commission combers, such as the defendant, who comb wool owned by others for a commission, and by others who integrate such operations with spinning and weaving and perform them principally for their own account.

At the time when the defendant commenced business its officers were familiar with practices and charges made by other commission combers. Albert I. Alexander, the defendant's president and chief executive, had been employed for many years as superintendent of the combing department of an integrated mill. The defendant established commission rates for combing which were comparable and competitive with those charged by other commission combers. Such rates were the fair market rates at that time. The rates so established were frozen by the General Maximum Price Regulation issued by the Price Administrator on April 28, 1942, under the Emergency Price Control Act, and have never

been changed, although the defendant's operating costs have increased substantially during the remainder of 1942 and the first six months of 1943.

The defendant during the fiscal years ending June 30, 1942 and June 30, 1943 had no direct contracts with any department or other agency of the United States. It combed wool principally for Nichols & Company, Inc., a topmaker. It did some work for others. It did not enter into formal contracts for such work, and no order or other memorandum of a contract contained any provision with respect to renegotiation. None was for an amount in excess of \$100,000. It rendered bills for its charges weekly and such bills were paid promptly.

It was the practice of Nichols & Company, Inc. and of other topmakers to ship lots of wool to the defendant's mill with instructions as to the grade and type of tops which it expected the defendant to comb therefrom, and occasionally at the same time but usually later to direct the shipment of the tops produced to the customers of the topmaker. The result was that the defendant often, although not invariably, knew the destination of the tops which it produced.

The defendant also knew that during the period from April 28, 1942 to June 30, 1943 the War Department and the Navy Department were purchasing and contracting for the purchase of woolen cloth, principally made from tops of grades 64 and 62. It believed that at certain times substantially its entire production of tops of those grades was ultimately used to perform such contracts. It also understood, however, that no tops were accepted for use in such contracts until they had been approved by inspectors for the War Department and the Navy Department. The defendant furnished samples of each lot of tops produced to Nichols & Company, Inc. for inspection and for use in offering said top to customers. The defendant was informed that Nichols & Company, Inc. sent wool to be combed at other combing mills and believed that it combed only a fraction of the tops sold by Nichols & Company, Inc. and others for whom it rendered services. It understood that the mills to which it made delivery



bought tops produced at other combing mills for Nichols & Company, Inc. and other topmakers. It understood also that the textile mills which bought tops and yarn spun from tops carried inventories of tops and yarn. It did not know whether at the time it made shipments to woolen mills there were in existence contracts with any Department or other agency of the United States for the performance of which the tops shipped were required, or in which they were subsequently used. It believes that the tops shipped were actually used by the consignees in the performance of Government contracts made before or after shipment, or in the performance of civilian contracts, that is, contracts not within the definition of a contract or subcontract in the Renegotiation Act, as such consignees determined their requirements from time to time. Tops produced by any other combing mill and sold by any topmaker, if of the same grade and having like characteristics, could be freely substituted for tops produced by the defendant. Such substitution might occur after the tops had been spun into yarn. Tops combed by the defendant might be stored for some time by the customer to whom they were shipped before their use was determined.

Representatives of the defendant met with members of the Boston Quartermaster Price Adjustment District Office in Boston on June 10, 1943, June 26, 1943, September 9, 1943, and September 30, 1943; with members of the Quartermaster General's Office in Washington, D. C. on December 16, 1943; and with members of a panel from the War Department Price Adjustment Board in Washington on May 26, 1944 and on June 16, 1944. The first two conferences dealt only with the defendant's sales and profits for the fiscal year ending June 30, 1942; the others dealt with the defendant's sales and profits for that year and the succeeding fiscal year. At such conferences the defendant submitted to the representatives of the various price adjustment agencies all information which it was requested to furnish, including letters from its customers containing estimates of the end use, divided as between Government and civilian use, of the tops which it had combed for such customers.

No evidence was presented at any of said meetings as to the prices which the United States paid for materials incorporating top combed by the defendant, nor as to whether those prices were fair and reasonable prices, nor as to whether they resulted in profits or losses to the sellers, nor as to whether any profits realized thereon were reduced by renegotiation.

No evidence was presented at any of said meetings as to sales, prices, and profits of any other person engaged in the business of combing wool or in any other like business, although the representatives of the Government stated that such data was available to them and was considered by them in making a determination that the defendant realized excessive profits. At the meetings in Washington on May 26, 1944 and June 16, 1944 the defendant, by its attorney, expressly requested that such data be disclosed to the defendant so that it might, if possible, contradict or explain the inferences to be drawn therefrom or offer other evidence to contradict, explain, or supplement such data.

No statement was ever furnished to the defendant of any standard to be applied in making a determination as to whether it realized excessive profits. On the contrary, it was represented to the defendant at said meetings that there was no standard which could be disclosed to the defendant, that each case stood on its own facts, and that the representatives of the United States with whom the defendant conferred had no authority except to make inquiries, to assemble facts, and to propose amounts to be refunded by the defendant as excessive profits which such representatives would recommend to other persons superior to them in the hierarchy of the War Department Price Adjustment Board. No hearing was ever given the defendant before any person authorized to make a determination that it had realized excessive profits.

No issue, which the defendant was called upon to meet, was ever presented at any of said conferences until an amount to be refunded as excessive profits was proposed, although after inquiry by representatives of the price adjustment agencies had concluded the defendant was invited to submit any facts which it thought

pertinent into an inquiry as to whether its profits were excessive. The defendant submitted evidence that its profits during the periods involved, by reason of the freezing of its charges under the General Maximum Price Regulation and the increase in its labor costs and other costs, were less than they would have been under normal competitive conditions, and was informed that profits under normal competitive conditions were not a standard and that under war conditions a margin of profit as great as that which a combing mill obtained under normal competitive conditions should and would be considered excessive.

No written statement of the facts used as a basis for the orders dated September 6, 1944, and of the reasons for the determinations made by said orders was ever furnished to the defendant.

The defendant, by its attorney, at the last meeting on June 16, 1944, pointed out that such a statement was required with respect to fiscal years ending after July 1, 1943 under Subsection (c) (1) as amended by the Revenue Act of 1943, and requested that such a statement or a copy of a report of any findings by the members of the panel to the War Department Price Adjustment Board be furnished to the defendant; but the presiding officer refused, stating that it was contrary to the policy of the Board to furnish any copy of findings or statement of reasons to contractors or subcontractors.

ALBERT I. ALEXANDER.

COMMONWEALTH OF MASSACHUSETTS.

SUFFOLK, SS.

BOSTON, MASSACHUSETTS, April 2, 1946.

Subscribed and sworn to before me this second day of April, 1946.

EDWARD C. PARK,

*Justice of the Peace.*

# CERTIFICATE OF CLERK OF THE TAX COURT.

UNITED STATES OF AMERICA,

DISTRICT OF COLUMBIA, SS.

I, B. D. Gamble, clerk of The Tax Court of the United States, hereby certify that I have examined the index record of cases filed of record in this The Tax Court of the United States and do not find any case or proceeding of any kind or character filed by or under the name of Alexander Wool Combing Co..

[SEAL]

B. D. GAMBLE, *Clerk.*

Dated: Washington, D. C., December 26, 1945.

## NOTICE OF APPEAL.

[Filed June 21, 1946.]

Notice is hereby given that Alexander Wool Combing Company, defendant in the above-entitled action, appeals to the Circuit Court of Appeals for the First Circuit from final judgment entered in this action on June 21, 1946.

EDWARD C. PARK,

*Attorney for* ALEXANDER WOOL COMBING COMPANY.

## STATEMENT OF POINTS.

[Filed June 21, 1946.]

The points upon which appellant intends to rely on this appeal are as follows:

1. The court erred in not dismissing plaintiff's complaint for failure to state a claim.
2. The court erred in ruling that the Renegotiation Act as applied to the defendant was constitutional.
3. The court erred in ruling that the plaintiff could recover on the unilateral determinations of the under secretary of war.
4. The court erred in ruling that the defendant's failure to petition The Tax Court for a redetermination of alleged excessive



profits rendered the unilateral determinations of the under secretary of war enforceable, even though made without due process of law.

By its Attorneys,

WITHINGTON, CROSS, PARK & McCANN.  
EDWARD C. PARK.

APPELLANT'S DESIGNATION OF CONTENTS  
OF RECORD.

[Filed June 21, 1946.]

Appellant designates the following portions of the record to be contained in the record on appeal in the above-entitled action:

1. Complaint.
2. Answer.
3. Motion for judgment on the pleading and for summary judgment.
4. Transcript of evidence, including affidavit of Albert I. Alexander, offered in lieu of evidence.
5. Opinion.
6. Judgment.
7. Notice of appeal.
8. This designation.
9. Any designation by appellee of additional matter to be included in the record.
10. Statement of points of which appellant intends to rely on appeal.

EDWARD C. PARK,

Attorney for ALEXANDER WOOL COMBING COMPANY,

Appellant.

June 21, 1946.

## APPELLEE'S COUNTER DESIGNATION.

[Filed June 25, 1946.]

Now comes the United States of America, plaintiff, appellee, by Edmund J. Brandon, United States Attorney for the District of Massachusetts, and hereby designates the complete record and all the proceedings and evidence in the action to be contained in the record on appeal.

EDMUND J. BRANDON,

*United States Attorney,*

by GEORGE F. GARRITY,

*Assistant United States Attorney.*

## STIPULATION AS TO RECORD.

Now come the appellant and the appellee by their respective counsel and stipulate, subject to the approval of the court, that the affidavits of G. Lyle Belsley and of Lieutenant Colonel Albert W. Tolman, Jr., may be omitted in the printing of the record on appeal but that the original affidavit or one unprinted copy of each such affidavit shall be physically transmitted to the Circuit Court of Appeals for the use of the court and such portions or summaries thereof considered material to the questions presented, which either appellant or appellee desires the court to read, shall be printed as an appendix to the brief of such party.

EDWARD C. PARK,

PHILIP F. GROGAN,

*Attorneys for Appellant.*

EDMUND J. BRANDON,

*United States Attorney,*GEORGE F. GARRITY, *Asst. U. S. Atty.,**Attorneys for Appellee.*

Approved: 29 August, '46.

C. MAGRUDER,

*U. S. Circuit Judge.*

## CLERK'S CERTIFICATE.

I, James S. Allen, clerk of the District Court of the United States, for the District of Massachusetts, do hereby certify that the foregoing is the record on appeal in the cause entitled:

No. 4121, CIVIL ACTION,

UNITED STATES OF AMERICA, Plaintiff,

v.

ALEXANDER WOOL COMBING COMPANY, Defendant,

in said District Court determined.

In testimony whereof, I have hereunto set my hand and affixed the seal of said District Court at Boston, in said District, this third day of October, 1946, A.D.

[SEAL]

JAMES S. ALLEN, *Clerk.*

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[MEMORANDUM: Orders of enlargement of time for docketing case to, and including, October 8, 1946, are here omitted. A. I. CHARRON, *Clerk.*]

## [fol. 241] PROCEEDINGS IN THE CIRCUIT COURT OF APPEALS

On February 5, 1947, this case came on to be heard, and was fully heard by the court; Honorable Armistead M. Dobie (by special assignment), Honorable John C. Mahoney, and Honorable Peter Woodbury, Circuit Judges, sitting.

Thereafter, to wit, on March 26, 1947, the following opinion of the court was filed:

## OPINION OF THE COURT—March 26, 1947

## PER CURIAM:

We think the court below adequately covered all the issues in this case and we affirm its judgment upon the grounds and for the reasons set forth in its opinion at 66 F. Supp. 389.

*The judgment of the District Court is affirmed.*

On the same day, to-wit, March 26, 1947, the following judgment was entered:

## JUDGMENT—March 26, 1947

This cause came on to be heard February 5, 1947, upon the transcript of record of the District Court of the United States for the District of Massachusetts, and was argued by counsel.

Upon consideration whereof, It is now, to wit, March 26, 1947, here ordered, adjudged and decreed as follows: The judgment of the District Court is affirmed.

By the Court, (S) Athur I. Charron, Clerk.

Thereafter, to wit, on April 2, 1947, mandate was stayed until further order of court.



[fol. 242]

## CLERK'S CERTIFICATE

I, Arthur I. Charron, Clerk of the United States Circuit Court of Appeals for the First Circuit, certify that the foregoing pages, numbered 1 to 241, inclusive, contain and are a true copy of the record and all proceedings to, and including April 2, 1947, in the cause in said court, numbered and entitled, No. 4205, Alexander Wool Combing Company, Defendant, Appellant, vs. United States of America, Plaintiff, appellee.

In testimony whereof, I hereunto set my hand and affix the seal of said United States Circuit Court of Appeals for the First Circuit, at Boston, Massachusetts, in said First Circuit, this second day of April, A. D. 1947.

Arthur I. Charron, Clerk. (Seal).

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SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed June 16, 1947

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the First Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(1565)